



Funding for Growth

A GE Capital research report into the 2010 growth outlook for small and medium sized firms based in the UK



GE imagination at work

Forward

Arguably, 2009 can be termed the “year of survival” for many UK businesses; cost cutting, optimising resources, deferring investment decisions and shoring up balance sheets. The aftermath of the financial crisis, the uncertainty of an economy in recession underpinned with changes in the socio-political environment, have necessitated a shift in focus for businesses. Whilst the survival mentality of 2008/09 continues, businesses in 2010 have begun to re-address the decisions they deferred in the last year whilst bringing the focus on accelerating growth in an uncertain world to the top of the agenda.

At the coalface of these challenges are the owners and managers of established small and medium sized enterprises (SMEs*). These individuals run over 200,000 businesses across the UK, accounting for over 20% of private sector employment. In short, their success is paramount to the future stability and well being of the UK economy.

As SMEs struggle in the face of high raw material and inventory costs, uncertain consumer and business spending, increased regulation and the increased price of fuel, the challenge will now be to understand what they need to focus on to secure growth in an uncertain market and how to access funding for growth for their businesses.

This report seeks to explore how confident SMEs are in respect of their own growth prospects. More specifically, what lessons these businesses have learned, how they have been funding themselves and how they perceive access to finance in the current economic climate.

About GE Capital in the UK

At GE Capital, we understand how the landscape and agenda for ambitious firms across the UK has now shifted. As one of the largest non-bank financial institutions in the UK, GE Capital has a central role to play in driving choice and enabling UK businesses to access innovative forms of funding that allow them to fund growth during these uncertain times. These solutions rely on a deep understanding of industry dynamics, investment in capital and working capital investments that are able to grow and flex with businesses as they seek to grow.

John Jenkins,
CEO, GE Capital, UK

The Research

GE Capital commissioned an independent market research company, The Survey Shop, to interview 500 owner managers of UK based *SMEs (owner/managed businesses with between 10 and 249 employees). The research was conducted anonymously by phone in March 2010. GE Capital also conducted comparable studies in 2008 and 2006 and 2008 and 2006 results cited throughout this report are references to these studies.

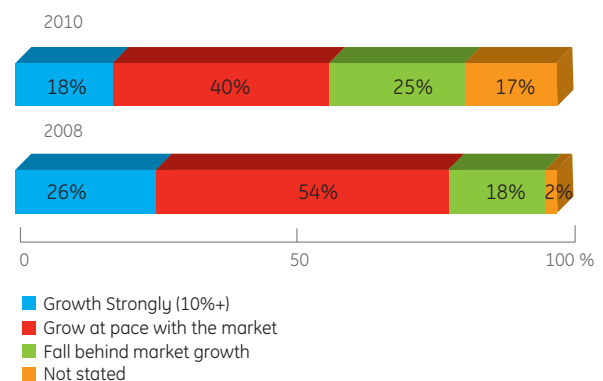
The Research Headlines

- SMEs in the UK are less optimistic about their growth prospects in 2010 compared with 2008 and 2006, with a quarter (25%) of firms saying that they expect to fall behind the overall growth in the market, compared with 18% in 2008 and 12% in 2006.
- Firms in the North West and Greater London are the most positive about their growth prospects, whilst firms in Scotland, the South East, the West Midlands and Wales are the least positive. Only firms in East Anglia/Midlands and the North West are more positive than they were in 2008.
- Almost two fifths (39%) of companies see high raw materials and inventory costs as one of the three limitations to their success, making it the biggest concern among UK SMEs. The worry over costs was higher than fears over the decline in consumer and business spending in the UK, which 38% of SMEs identified as a limitation to their success. Reassuringly, less than one in ten businesses (8%) put a lack of available investment as one of their top three growth challenges. This compares favourably with pre-downturn research when 12% put it in their top three.
- Winning new business remains the top priority for 81% of businesses in 2010 with 99% of firms expecting their growth to come from additional sales. However the vast majority of UK SMEs (91%) expect that their growth will come from domestic sales over the next three years making them reliant on the fortunes of the UK economy. This appears to be at odds with the UK's expectation of an export driven upturn.
- A healthy 83% of businesses surveyed believe they have sufficient levels of cash and lending facilities to service their business and deal with immediate problems or have a significant cash buffer and lending facilities to have a healthy cash position. However, 16% say they still live hand to mouth, with little cash to cover emergencies; this is most common in the transportation and distribution sector. The most cash rich sectors appear to be IT and telecoms (80%) and leisure and catering (69%) citing sufficient levels of cash to service the business and deal with immediate problems.
- 18% of SMEs have missed an opportunity in the last year due to a lack of funding, losing an average of £822,000. This compares with just 9% in 2008. 43% of SMEs expect it to be more challenging to access the funding they need over the next 12 months, compared to 31% in 2008.
- Over one in four SMEs (27%) believes that the financial services market is not at all competitive for small businesses. This was most prevalent with SMEs in the South East and West Midlands. Conversely, out of the SMEs surveyed in Greater London, two thirds (66%) felt that the market was extremely competitive in providing financial services to businesses.

Growth prospects remain depressed amidst continued uncertainty

The effects of recession, high raw material and inventory costs, fears about consumer and business spending, increased regulation and the price of fuel, have all led to a diminished growth outlook among SMEs. When asked to comment on their sales growth over the next 12 months only 18% said that they expected to grow strongly in 2010, compared with over a quarter (26%) of firms in 2008 and nearly a third of firms (31%) we asked in 2006. Whilst it is encouraging that a significant number of firms are expecting to grow between 3% and 10%, it is concerning that the number expecting their sales to contract (i.e. grow slower than the market) has risen from 18% in 2008 to 25% in 2010 (See Chart 1).

Chart 1 – Forecast Sales Growth for the next 12 months



Optimism is dampened across all industry sectors

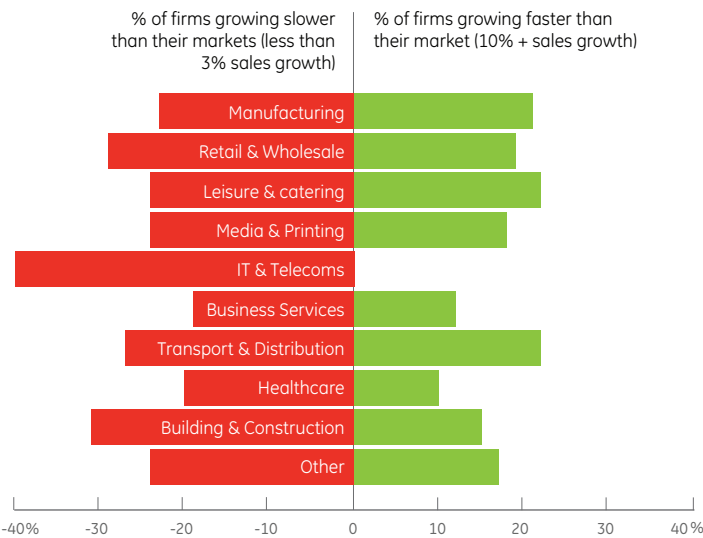
In 2008, the impacts of the credit crunch and the economic environment were beginning to make themselves apparent. Whilst 32% of business services firms predicted strong growth in 2008, in 2010 the downward trend continues with only 12% forecasting strong growth. These challenging times are being experienced across all industry sectors with no more than 22% in any sector forecasting strong growth in excess of 10%.

The most negative sectors include IT and telecoms with 40% saying that they expect to fall behind market growth, similarly building and construction (31%), retail and wholesale (29%) and transport and distribution (27%) all feel that their growth will be stifled in the coming year, reflecting in part the fear of reduced customer and business spending (See Chart 2).

Continued reliance on domestic sales

Now that the long awaited export-led recovery shows signs of emerging, it is concerning that firms continue to place such a heavy emphasis on UK sales to drive their growth agenda. 91% of SMEs cited organic domestic sales as their primary growth driver (See Chart 3) compared to 81% in 2008 and 69% in 2006. Furthermore, only 8% expect their growth to come from international sales over the next 3 years.

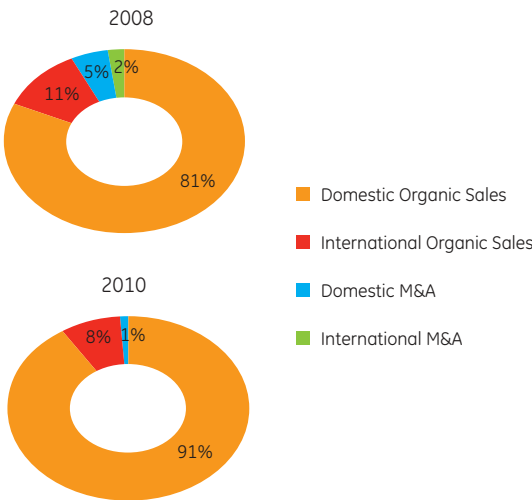
Chart 2 – Sector Breakdown of Growth Expectation



It appears that fewer SMEs are taking advantage of export opportunities compared to two years ago, despite very favourable export conditions. In fact, given the expectation that the pound will remain weak against the US dollar and the Euro for the foreseeable future, less than one in 10 (8%) of SMEs put overseas expansion as a business priority for the year ahead.

Furthermore, of those companies that do export, almost three-fifths (59%) continue to invoice their overseas customers in sterling rather than in the foreign currency of their buyer, compared to 53% in 2008. As a result, these businesses could miss the opportunity to either increase volumes or take advantage of the weak pound through higher profit margins.

Chart 3 – Sources of Anticipated Sales Growth over the next 12 months

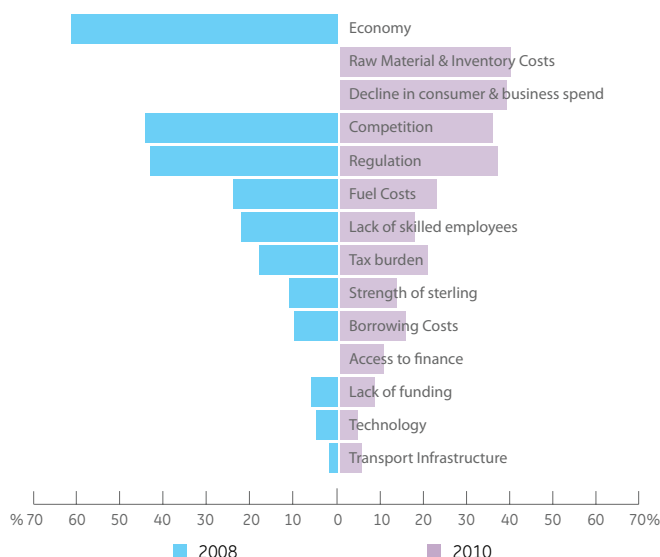


SMEs are struggling with raw materials and inventory costs

Over and above the general economic conditions, the real news is that SMEs in the UK are struggling in the face of high raw material and inventory costs. This was deemed to be the largest constraining factor on growth with 39% of SMEs citing it as the top limitation on their success, followed by fears about consumer and business spending, which was identified by 38% of SMEs as a limiting factor. In addition, the increased burden of regulation (36%) and, not surprisingly, the price of fuel (22%) were also cited by SMEs as significant worries.

What is surprising is that, whilst borrowing costs and access to finance remain very topical, only 15% and 10% respectively of SMEs cited these factors as key limitations to growth. In addition, lack of available investment was mentioned by just 8% of SMEs, up only 2% from last year (See Chart 4).

Chart 4 – SME top 3 Constraints on Growth



Lessons learned from the recession are updating business priorities

Whilst it may be difficult to adjust to the impact of a recession, often, one of the most positive outcomes is that it forces business to think more clearly about how they can be more prepared for adverse economic conditions and how they can protect and safeguard their business in the future. In 2010, a quarter of all SMEs (25%) felt that the greatest lesson they learned was to adapt more quickly to the changing needs of their customers whilst others (22%) became more cost conscious and now realise the importance of being able to take non-essential costs out of the business quickly. A fifth (20%) of businesses also realised that they needed a more robust process for budgeting and planning, whilst almost one in five (19%) agreed that their key learning from the recession was that "Cash is King" (See Chart 5).

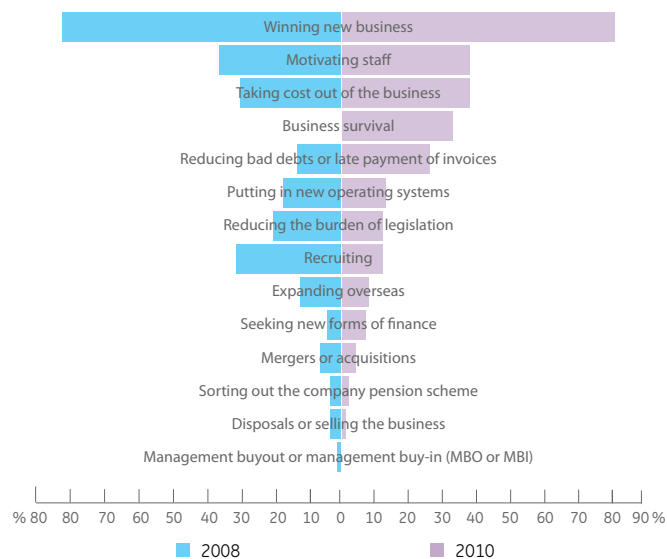
Outside of winning new business, which remains the priority for 81% of SMEs in the UK (compared to 83% in 2008), motivating existing staff has become a core focus for over a third of businesses (38%), which is a slight increase on the 36% in 2008. What has changed over the last two years is the focus on recruiting new staff, which has fallen from 31% in 2008 to 12% in 2010. This is once again reflective of the general sentiment during recessionary times whereby businesses hope to keep their best staff to drive the success of the business and therefore, not surprisingly, a third of businesses (33%) also cited a focus on business survival as a priority (See Chart 6)

Chart 5 – Key Lessons learned from the recession



Chart 6 – SME Top 3 Business Priorities

Firms are keeping track of their financial health

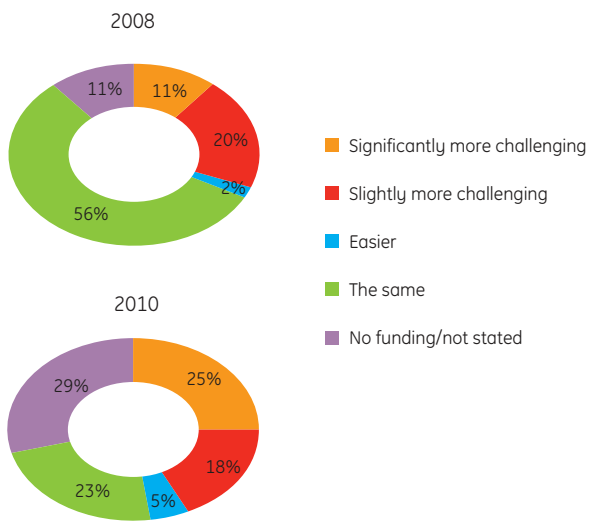


SMEs across the UK appear to regularly assess the financial health of their organisations. 79% of owners and managers cite sales as the measure that they monitor regularly. Cash in the bank was the second most common measure of financial health with 77% of firms mentioning it. Costs were also scrutinized by 63% of those firms who were keeping track of their financial wellbeing. This monitoring of financial health may contribute to the positive cash positions of many UK SMEs. 59% of firms believe that they have sufficient levels of cash to service their business and deal with immediate problems and a further 24% believe they have a significant cash buffer and lending facilities to have a healthy cash position. Only 16% of firms admit that they live hand to mouth with little cash to cover emergencies.

Access to funding is expected to become more difficult

At the time of this survey, only 7% of our sample said that new forms of finance were a top priority for them representing a 3% increase on 2008. However, when considering that almost a third (31%) of SMEs believe that they would need to seek additional bank/external funding if their sales were to grow, coupled with the fact that 40% of SMEs believe that their annual sales growth over the next 12 months will grow with their overall market at between 3% and 10%, then we assume there will be a longer term demand for funding. On the flipside, 43% of SMEs believe it will be more challenging to get the funding they need over the next 12 months; of those, 25% believe it will be significantly more difficult compared to just 11% in 2008 (See Chart 7). As it stands, this may present a significant concern for the accelerated recovery of the economy. SMEs will need to find innovative ways to access finance from other sources to grow their firms and consequently, the economy. Notwithstanding these figures, over half (54%) of all SMEs believe that the market is at least relatively competitive in providing financial services to businesses.

Chart 7 – How much more difficult will it be to raise funding in the next 12 months



Invest in understanding as well as availability

For those owners and managers who do require funding, it will be critical to access the right type of funding to suit their needs and the needs of their business. In that regard, SMEs are placing importance on lenders who deeply understand the challenge of growing through uncertainty with 43% of all SMEs citing that better information and advice would make for a more competitive financial services market. In addition, 45% of them felt that greater transparency on charges would be of benefit to them. Where financial advisers are concerned, 15% of all SMEs stated that they could do with more help on understanding the advantages and disadvantages of different types of funding (See Chart 8).

Chart 8 – What can financial advisers do to help SMEs get more/better funding for their businesses

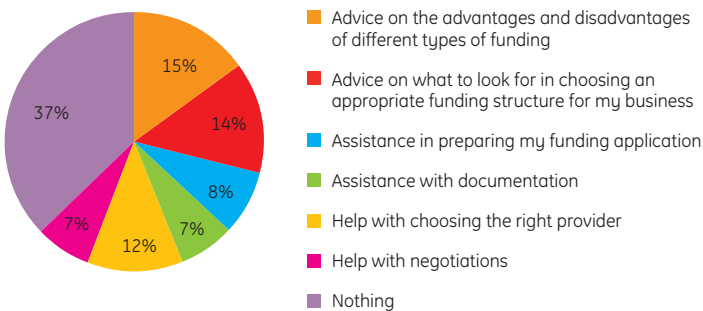


Chart 9 – Regional Sales Growth Outlook



Regional Optimism

While overall sales growth forecasts have fallen in comparison with 2008, there are significant variations across regions (see Chart 9), with Greater London and the North West being most optimistic and West Midlands, the South East and Scotland being the least optimistic in terms of their sales growth net balance (nb: the net balance is the percentage of firms who expect to grow ahead of the market, minus those who expect to grow less than the market).

Year on year optimism is down across the board with the exception of the North West, which reported the only increase in sales confidence with the net balance in the region rising from +2 in 2008 to +10 in 2010 and also Wales where the net balance rose slightly from -16 in 2008 to -14 in 2010.

By way of contrast, firms in Scotland saw the biggest drop in confidence with the net balance falling from +26 in 2008 to -20 in 2010. The North East and South East also witnessed significant falls in sales growth confidence between 2008 and 2010.

Greater London

Despite the continued uncertainty in the financial markets, SMEs in London still remain more confident around their growth prospects than many of their regional counterparts with 28% expecting to grow sales by more than 10% in 2010. That said, in contrast to 2008 sales, growth optimism has fallen with the overall net balance falling from +20 in 2008 to +8 in 2010.

Top priorities for businesses in this region are; winning new business (82%), business survival (38%), motivating staff (36%) and taking cost out of the business (36%).

Notwithstanding general economic conditions, increased competition (38%) and high tax burdens (36%) are perceived to be the greatest constraints for London-based SMEs. In addition, concerns around the strength of sterling are prevalent among SMEs in London with almost a quarter (24%) rating this in their top three growth constraints, compared to 13% nationally.

In terms of accessing finance, 44% of London SMEs believe it will be more challenging to get the funding they need in the next 12 months.

Scotland

Scotland's SME managers and owners are more pessimistic about their sales growth outlook for 2010 than in previous years, with only 10% expecting their sales to grow strongly at 10% or more and a significant 30% expecting their sales growth to be less than 3%.

Increased competition was Scotland's largest growth limiting factor with 44% citing it as one of their top three constraints. In a similar vein to the rest of the UK, higher cost of raw materials and inventory, decline in consumer/business spend and increased burden of regulation all represent concerns with 34% of all SMEs citing these factors as one of their top three constraints.

In order to deal with these constraints, almost half of all SMEs in Scotland (48%) believe that motivating their staff is a top priority for the year alongside winning new business (76%). Unsurprisingly, business survival also tops their list with 40% of SMEs citing it as a priority. Linked to this is the Scottish SME's focus on reducing bad debts and late payment of invoices, with 30% deeming this as a priority. Firms in Scotland are the most concerned in the UK about access to finance, with 18% citing this as one of their top three concerns.

30% of SMEs in Scotland believe that getting the finance they need over the next 12 months will more challenging than ever.

Wales

Whilst the Welsh SMEs optimism for sales growth is low, with only 12% expecting to grow above the market and nearly 26% expecting to grow at less than 3%, this actually represent a slight increase in confidence over the net balance in 2008 (-16 in 2008 to -14 in 2010). This subdued optimism seems to be impacted by the Welsh firms' concerns over a decline in consumer and business spending with 42% citing this as a key constraint on the success of their business. Costs seemed also to be a critical factor with 40% stating that higher costs of raw materials and inventory and 32% stating that the price of fuel were in their top three constraints. Unsurprisingly, over half of Welsh SMEs (52%) deemed taking cost out of the business to be one of their top three priorities for the year along with business survival (42%).

In addition, 42% of Welsh SMEs believe it will be more difficult to access the finance they need in the coming year.

East Anglia / Midlands

Optimism in East Anglia/Midlands has slightly improved in 2010 with 20% of SMEs predicting that their sales will grow at greater than 10% compared to 2008 when only 18% of SMEs believed that they would grow strongly. . However, those SMEs who believe they will fall behind the overall market have increased from 20% in 2008 to 32% in 2010.

Firms in the region are most concerned with higher costs of raw material and inventory with 44% stating that this is one of their top three constraints. Therefore, they are more likely to cite taking out cost as one of their top three priorities with 38% mentioning this. In addition, SMEs in East Anglia/Midlands are the only ones in the country who deem management buy-outs or buy-ins to be one of their top three priorities this year (2%).

SMES in East Anglia / Midlands are concerned about access to funding with over half (54%) stating that they expect not to get the funding they need.

North East

In the North East, optimism has fallen since 2008 (from a net balance of +12 to -6 in 2010). Business survival (46%) and motivating staff (46%) appear to be on the list of priorities for businesses, whilst they are most likely to cite the increased burden of regulation as one of their top three constraints to growth, with over half (52%) of SMEs in the North East mentioning this compared to 36% nationally. They are also most likely to cite increased competition as one of the biggest constraining factors with 42% mentioning this compared to a 35% national average.

In addition, North Eastern SMEs appear more concerned with getting the funding they need over the next 12 months, with 54% believing it will be more difficult against 43% nationally

Yorkshire and Humberside

Firms operating in Yorkshire and Humberside have seen a considerable drop in optimism in the last two years, with the percentage of SMEs stating that they will grow strongly decreasing from 36% in 2008 to 20% in 2010. In addition, those who believe they will fall behind the overall market, with growth of less than 3% has increased by 10% since 2008 to 16% in 2010.

Fears about a decline in consumer and business spend appear to be fuelling this dip in confidence with 44% of SMEs citing this as the biggest constraining factor on their success, against a national average of 38%. In order to counter this concern, the SMEs in this region have cited that taking cost out of the business is their highest priority (40%) behind winning new business (92%).

North West

SMEs in the North West appear to be the most optimistic in the UK with 30% stating that their sales will grow strongly at 10% or more in the coming months. This also represents an increase on 2008 when only 20% felt that this was indeed the case.

In order to drive this growth, 46% of SMEs in this region believe that in addition to winning new business (76%), taking costs out of the business must be a priority (46%).

In addition to higher costs of raw materials and inventory and a decline in consumer and business spend being cited as top three constraining factors by 42% of SMEs in the region, the price of fuel appears to be one of their top three priorities with 32% mentioning this against 22% nationally.

Two in five (42%) SME owners and managers in the North West also believe that they will find it more challenging to access funding in the coming months.

South East

In terms of their sales growth net balance, SMEs in the South East have seen a considerable decline in optimism since 2008 (+6 in 2008 to -18 in 2010). Only 12% of the SMEs surveyed believe that they will grow strongly over the next 12 months.

Increased burden of regulation and increased competition were the top 3 concerns cited by 34% of the SMEs. The price of fuel also appeared to be one of the top three constraining factors with 26% of firms mentioning this against 22% nationally.

The top priorities for businesses in the region are winning new business (80%) and motivating staff (36%) whilst they will also focus on reducing bad debts and late payment of invoices (28%)

48% of SMEs believe that getting the funding they require in the next twelve months will be more challenging.

South West

In terms of growth outlook over the next twelve months, the South West remains relatively optimistic with 50% of companies foreseeing sales growth in line with the market of between 3% to 10% and an additional 22% expecting a higher growth rate of 10% or more.

Behind winning new business, firms in the South West are most focused on taking cost out of the business as a top priority (48%). Reducing late payment and bad debts (30%) are also in their top priorities compared with 26% nationally.

In addition to higher costs of raw materials and inventory and a decline in business and consumer spend, 36% SMEs in the South West were concerned with increased competition compared with a national average of 35%.

In terms of accessing finance, SMEs were less convinced than other regions that getting the funding they need would be more challenging with only 38% stating this compared to a national average of 43%.

West Midlands

Firms in the West Midlands are towards the bottom of the regional growth league, with only 10% of firms expecting to grow their sales in excess of 10% over the next 12 months and 28% of firms expecting to grow slower than their markets overall (less than 3% growth).

SMEs in the West Midlands were most likely of all of the regions to cite the high costs of borrowing and lack of available investment as key concerns with 22% and 16% respectively in their top three growth constraints compared with only 15% and 8% nationally.

Winning new business remains a priority in the West Midlands (84%) along with motivating staff (40%). However the SMEs in this region (18%) also mentioned reducing the burden of legislation as a priority compared with 12% nationally.

In line with the rest of the country, 42% of SMEs in the West Midlands believe it will be more challenging to get the funding they need over the next 12 months, with 28% believing that it will be significantly more challenging.

GE Capital in the UK

GE Capital is an independent, specialist financier, serving UK SMEs where it can add value, leveraging its industrial history and solving funding challenges for businesses. It has a clear place in the financial market to support SMEs with operational financing.

In 2009, GE Capital provided finance to over 50,000 UK SMEs and provided over £5 billion of working capital.

Since 2007, GE Capital has financed more than £1bn of equipment and over 40,000 fleet cars for business in the UK together with almost \$20 billion of equipment and fleet investment in Europe since 2007. Across Europe, GE Capital provides more than \$100bn of working capital to SMEs every year and has provided half a trillion dollars of working capital to European companies (volume) through AR financing since 2004. GE Capital manages more than 250,000 cars in Europe and 1.5m worldwide.

Reigate

Enterprise House
Bancroft Road
Reigate
RH2 7RT
+44 (0)1737 84100

Bristol

2630 The Quadrant
Aztec West
Bristol,
BS32 4GQ
+44 (0)870 241 8899

Sale

Old Hall Road,
Sale
M33 2GZ
+44 (0)870 458 8701

Visit us on-line at:
W. www.businessfinance.co.uk
E. businessfinance@ge.com

Birmingham

4th Floor,
Bank House,
8 Cherry Street,
Birmingham,
B2 5AL
+44(0)121 616 4380

London

(Until September 2010)
50 Berkeley Street
London
W1J 6EW
+44 (0)20 7302 6200

London

(From September 2010)
The Ark,
201 Talgarth Road
Hammersmith
London
W6 8BJ

