codat

Closing the small business funding gap

The next frontier for Open Finance

Contents

Executive summary

This report focuses on UK SMEs that are open to accessing credit, revealing their motivations for borrowing, the barriers they face, and their attitudes towards data sharing for better credit options.

1. The Bank of England estimates that there is an SME funding gap of £22 billion.
    - 1.3 million UK SMEs needed external finance in 2022.
    - Over a quarter (27%) of SMEs in the market for credit say their businesses would grow faster if they could access credit more easily.
2. The funding gap exists because the SME credit landscape is not optimised for lenders or borrowers.
    - The unfriendly application process means that SMEs are not applying for finance when they need it — only 6% of them think that SME credit is good enough.
    - SMEs that are rejected don't have the time or the confidence to submit further applications.
    - Lenders lack the level of insight required to judge risk and affordability correctly.
    - It's also too expensive for lenders to service all of the loan applications they receive.
3. Codat is proposing the implementation of an SME Funding Passport as the solution required to improve access to credit for UK SMEs.
    - An SME Funding Passport is a digital file containing company financial data necessary for underwriting. The data within this digital file is consented, standardised, and easily shareable with lenders in real time.
    - Looking at attitudes to data sharing, the vast majority (90%) of SMEs with more than 10 employees are willing to share their data with lenders, especially in return for better rates and products.
    - Just over half (51%) of businesses say they would change their approach to funding if an SME Funding Passport were in place, with 31% saying they would borrow more often and 18% saying they would borrow more.
4. An SME Funding Passport solves the funding gap by addressing the problems faced by lenders and businesses. In doing so, the UK economy also benefits.
5. This report investigates the state of the SME funding landscape in the UK. It sets out the argument for an SME Funding Passport and details the required next steps to be taken by the industry and regulators to close the SME funding gap.

Understanding the SME funding gap

What does ‘funding gap’ actually mean?

According to the National Audit Office research on ‘Improving access to finance for small and medium-sized enterprises’, the SME funding gap refers to “the difference between the funding required by SMEs and the funding available”.

When former Governor of the Bank of England Mark Carney delivered his Mansion House speech in the summer of 2019, he cited a £22bn SME funding gap in the UK. Some estimates put this gap as high as £56bn.

This means that, conservatively, there is a £22bn gap stopping UK SMEs from operating as efficiently as possible, achieving their growth potential, and contributing fully to the economy.

Countless datasets show the immense value of SMEs to the British economy — they are the driving force behind it. The Bank of England’s own *Open Data for SME Finance report* highlights that the 5.6 million small businesses in the UK account for 50% of GDP, and 60% of all private sector employment.

The UK is staring into the face of recession and astronomical rises to the cost of living and doing business. These conditions are already making it harder for businesses to succeed. Business insolvencies are up 43% year-on-year as of August 2022. Access to credit will also become tougher as lenders decrease their appetite for risk — which will worsen the existing funding gap.

SME access to credit is one of the biggest challenges facing SMEs and the wider British economy.

Action must be taken to improve the lending outlook for Britain’s businesses.

Research methodology

To get a clearer picture, we conducted our own research into the SME funding landscape and analysed existing reports and data, including the SME Finance Monitor and the British Business Bank's SME Finance Survey.

For our research, Codat worked with independent research and business insights consultancy, BVA BDRC, which has been responsible for the respected SME Finance Monitor since 2011.

We ran online interviews (8th-17th August) with 872 senior financial decision makers in UK SMEs (under 250 employees)[1] to learn about their motivations for accessing credit, the barriers they face, and their attitudes towards data sharing for better credit options. The sample was made up of those in different business types, sizes, and industries. Data was weighted to business size, region, and macro industry code.

The focus of the data and subsequent analysis is on those who are open to credit, which for the purposes of this report we have called 'potential borrowers'.

These potential borrowers (57% of SMEs), are feeling the effects of the funding gap, rather than permanent non-borrowers (PNBs)[2] that have not and will not borrow (43% of SMEs).

We did, however, capture a robust sample (82) to understand if a better system would persuade PNBs to borrow, and benefit the economy beyond closing the credit gap.

SME finance — the state of play

What is the current demand for SME finance?

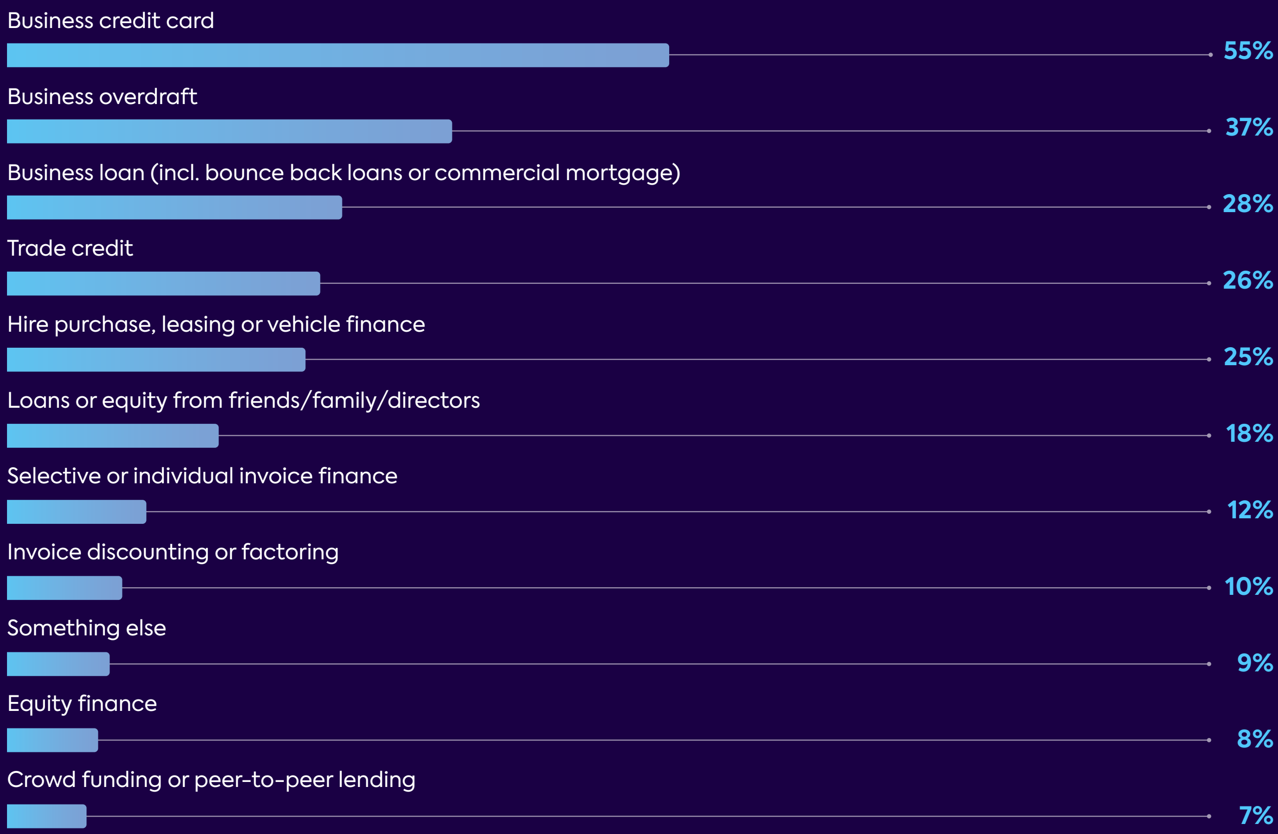
According to our research, over half (57%) of potential borrowers have used some form of external finance in the past five years (that is credit in the company's name, as opposed to personal credit used for the business) — and 50% are currently using a form of external finance.

The external credit market is dominated by traditional credit cards, overdrafts, loans, trade credit, and hire purchase finance. But, it should be noted that the larger SMEs are far more likely to use more innovative credit facilities, such as invoice, peer-to-peer, and equity finance.

57%

of SMEs have used a form of external finance in the last five years

TYPES OF EXTERNAL CREDIT USED BY SMES WITH CURRENT FACILITIES



Q: Are you using / have you used any of the following forms of business finance? Net: now / past 5 years / taken out in the past 12 months.
Base All potential borrowers (791)

What is the anticipated demand for SME finance?

Data from the first half of 2022 featured in the SME Finance Monitor shows that the proportion of all SMEs likely to have any future demand for finance is 24% — that's 1.3 million companies. This has reduced from 29% in 2021 and 35% in 2020.

A decrease in demand for funding is to be expected, given the vast loan bubble created by the COVID-19 pandemic and the ongoing interest rate rises which will increase repayment concerns. Historically, demand for external credit has been higher than we're currently seeing. However, there is a strong correlation between economic pressure and demand for funding. With 40% of SMEs already being significantly impacted by rising costs, we expect the demand for funding to rise over the coming months to help ease cash flow.

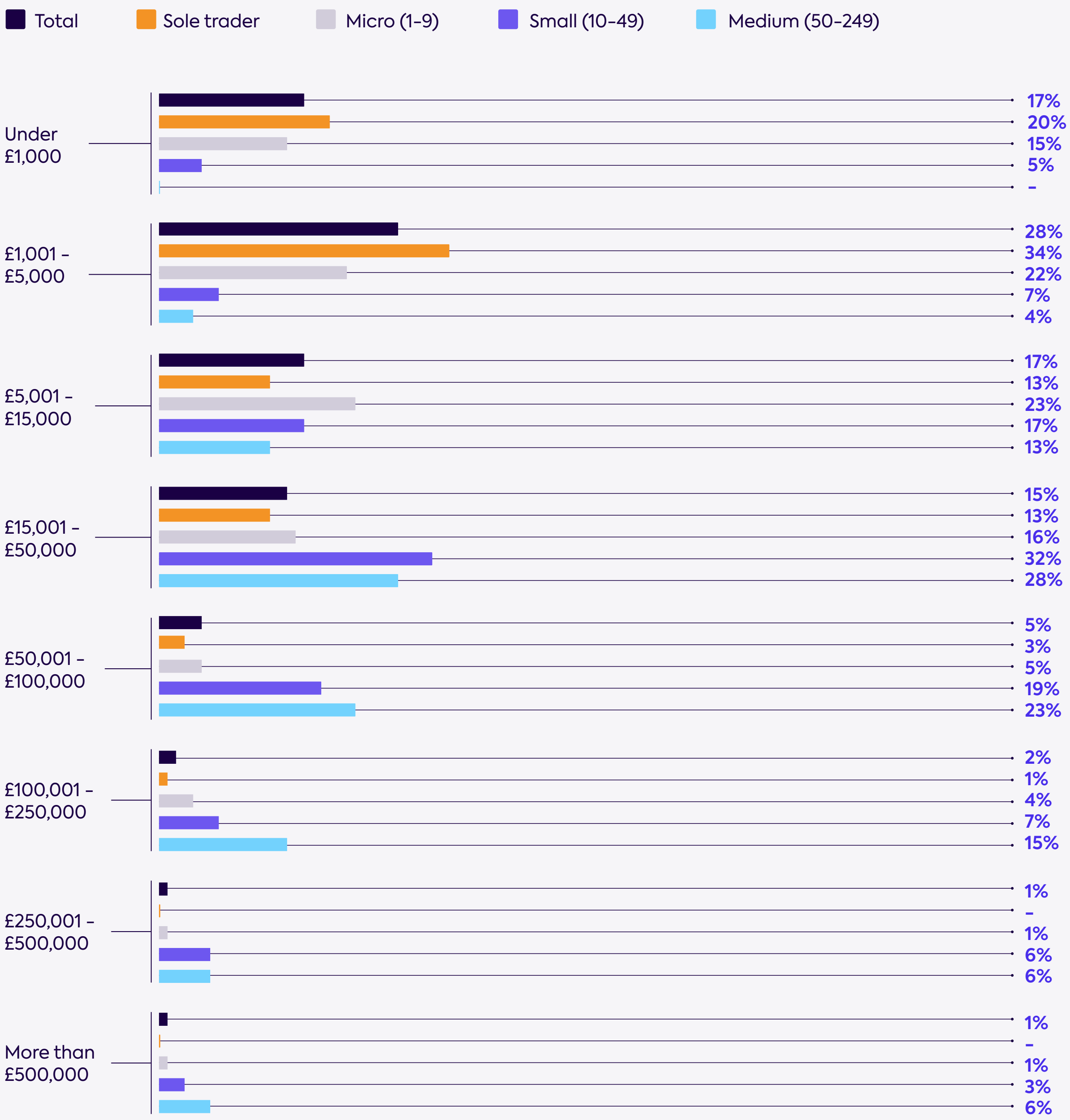
1.3 million

UK SMEs are expected to need external finance in 2022

How much do businesses need to borrow?

When they last borrowed, the majority of SMEs (62%) needed to access credit of £15K or less. A fifth (20%) needed between £15K and £100K and a small minority (4%) were looking for a loan bigger than £100K.

VALUES OF LAST EXTERNAL CREDIT RECEIVED



Q: Thinking of the last time you needed to access external credit (i.e. from a bank / lender / credit card / Islamic finance provider), not a personal credit facility or trade credit, how much were you looking to borrow, approximately? Base: All those using external finance (579 / 115/170/196/98)

What is the funding needed for?

The most common reason cited for requiring credit is to fund expansion in the UK — 26% of potential borrowers said that this is why they'd be applying for finance. The second most popular reason, chosen by 22% of businesses, was to secure working capital to help with day-to-day cash flow. Overall, 48% of these SMEs cited a reason linked to expansion of their business, 46% said they needed finance to plug cash flow gaps, and 41% said it would be used to buy equipment and fund R&D.

On top of this, over a quarter (27%) said that their business would grow faster if they could more easily access credit, rising to over half for those with more than ten employees.

All	
Cash flow	22%
Cover trading difficulties	16%
Invest in equipment	16%
New premises	15%
Invest in technology	9%

Smaller Companies (Sole + Micro)	
Recover from impact of Covid	16%
Cover a short-term funding gap	16%

Bigger Companies (Small + Mid)	
Expansion within the UK	36%
A new business opportunity	27%
Take on staff	27%
R&D	23%
Expansion overseas	18%
Approached by finance provider	14%
Taking over another company	9%

Q: Why will you be looking to apply for finance? What will the funding be used for? Base: All who will be applying for external funding in the next 12m / Sole + Micro / Small + Medium (368 /153 /215)

27%

say their business would grow faster if they could access credit more easily

Q: To what extent do you agree with the following: "My business would grow faster if I could more easily access credit." Net agree. Base: All potential borrowers (791)

Why does the funding gap exist?

The funding gap exists because the SME credit landscape is not optimised for lenders nor borrowers

The borrower perspective

The negative application process is off-putting for SMEs

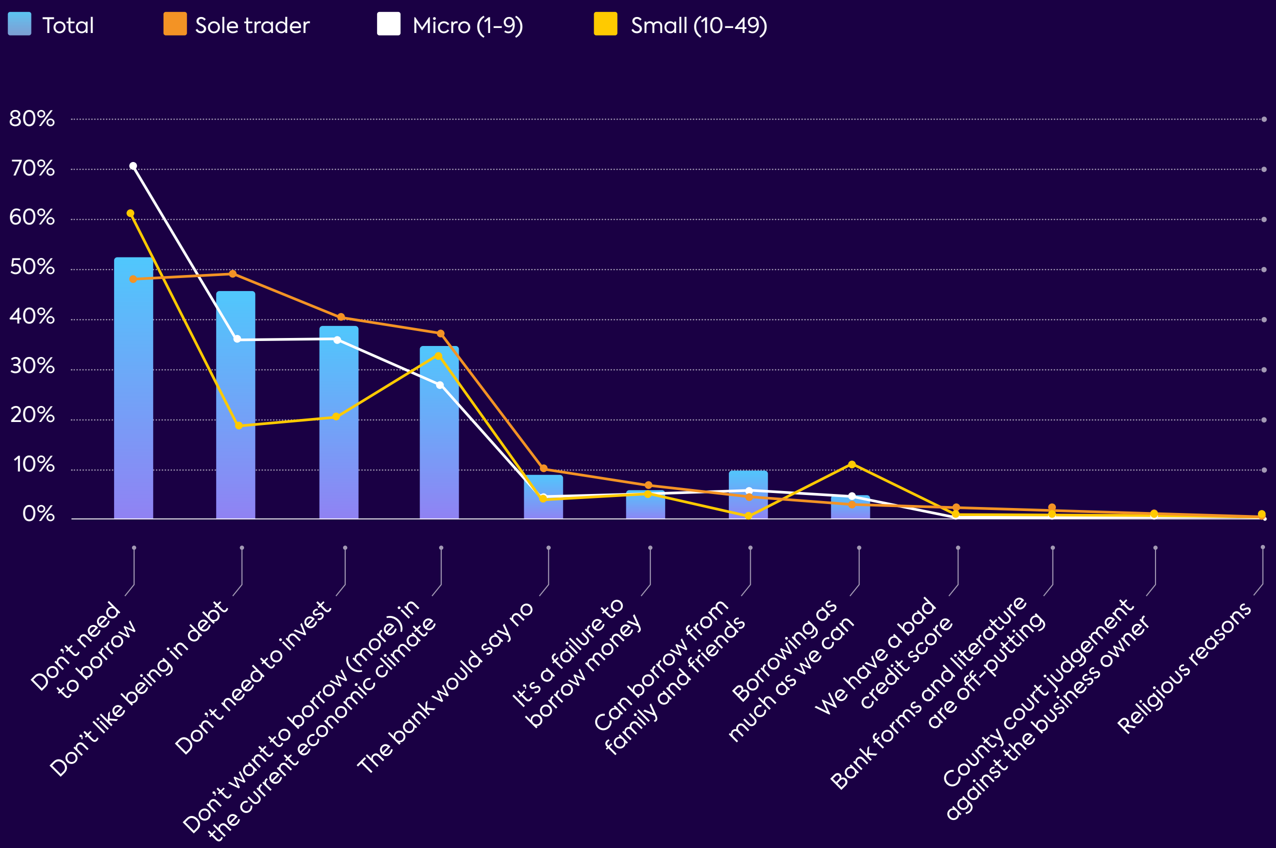
Most potential borrowers (72%) aren't planning on applying for finance within the next 12 months, leaving 28% likely to apply.

For the large majority unlikely to apply within the coming year, what are their reasons?

39%

of 'would-be-borrowers' don't borrow due to an off-putting process

REASONS NOT TO BORROW AMONG SMES



Q: Which of the following are reasons you will not apply for credit? Base: All respondents unlikely to apply for more external finance (423 / 210 / 113 /75): NB sample for medium businesses is 25 so too unstable to analyse independently of the main sample

→ See appendix on page 36 for full data breakdown

Grouping the categories together gives us the following results:

- **Most (71%)** say that they do not have a need for credit in the coming year
- **46%** are attitudinally adverse to taking on debt
- **37%** feel they have already taken out as much credit as possible
- **10%** find dealing with their bank off-putting
- **2%** have credit problems

The SME Finance Monitor cites the main reason (39%) that 'would-be borrowers' don't borrow is due to an off-putting process. So, of all the possible borrowers, there is a significant chunk actively avoiding the process due to an off-putting system.

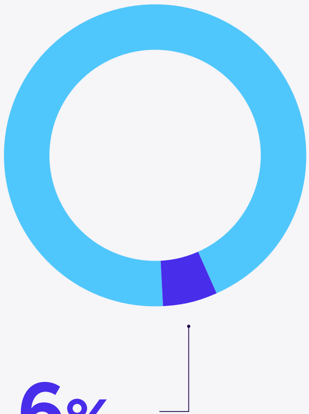
What specifically are their feelings towards the existing system and the application process?

The headline is that the vast majority of businesses see SME funding in a bad light. In fact, 73% of potential borrowers feel negatively about SME credit. This rises to 82% and 88% amongst small and mid-sized companies, respectively.

The most relatable statements to SME credit are:

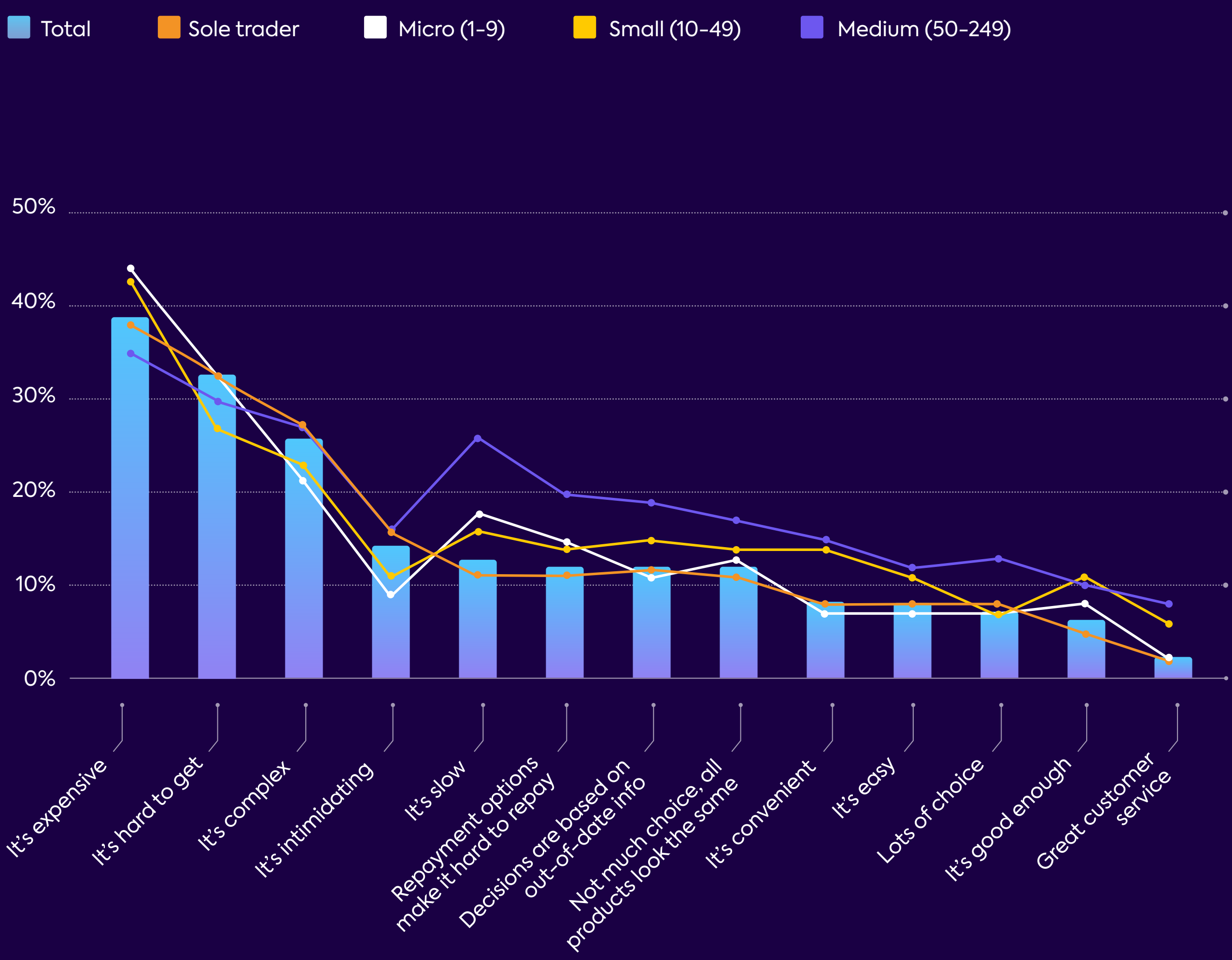
It's expensive	**39%**
It's hard to get	**33%**
It's complex	**26%**
It's intimidating	**14%**
It's slow	**13%**
Decisions are made based on out-of-date information	**12%**
The repayment options make it hard for my business	**12%**

Mark Carney's Mansion House speech in 2019 seconds this data, citing that almost half of SMEs wouldn't seek external finance because of the hassle and time it takes to apply.



6%
of SMEs think that SME credit is good enough

PERCEPTIONS OF FINANCE CURRENTLY AVAILABLE



Q: Which of the following do you agree with when it comes to the financing currently available to small and medium-sized businesses (SMEs), whether you use it personally or not? Base: All potential borrowers (791 / 271 / 205 / 214 / 101)

→ See appendix on page 37 for full data breakdown

Overall, only 6% say that SME credit is good enough. That leaves a colossal amount of room for improvement.

Applying for credit and dealing with banks is clearly putting small businesses off the process. The struggle of running a business without the funding it needs is preferable to going through the process of trying to secure that funding — and that's the first reason the £22bn funding gap exists.

Small businesses don't consider multiple lenders

There are varying data points on how businesses approach a credit application rejection, but they all tell the same story.

The Bank of England's *Open Platform for SME Finance report* highlights that 50% of SMEs only ever consider one provider when seeking a loan.

The latest SME Finance Survey by the British Business Bank backs this up, stating that less than one in ten (9%) will talk to another lender if they aren't offered the full loan amount their business needs. It also highlights that a pre-existing relationship is the most common reason for choosing to apply for credit with a provider, with 32% claiming to do this.

Further, our own research shows that 55% of potential borrowers have taken out a form of finance in a personal name, and used it for their business. This strongly suggests that rather than consider other providers and reattempt the process, many SMEs are choosing to take out personal loans for their business.

The overall story here is clear. SMEs tend not to consider multiple lenders when looking for credit:

They don't have the time or confidence to make multiple applications

The Bank of England says that 25% of UK SMEs are put off approaching multiple loan providers because it is too much hassle and takes too much time. This is corroborated by our own data, in which 34% agree that the application process is difficult to understand.

The chances of rejection are discouraging for businesses. According to the SME Finance Monitor, the confidence rate in a successful application was 52% in Q2 2022, down from 59% in 2019 — however, this still leaves half of all SMEs not feeling confident that their facility would be agreed if they were to apply.

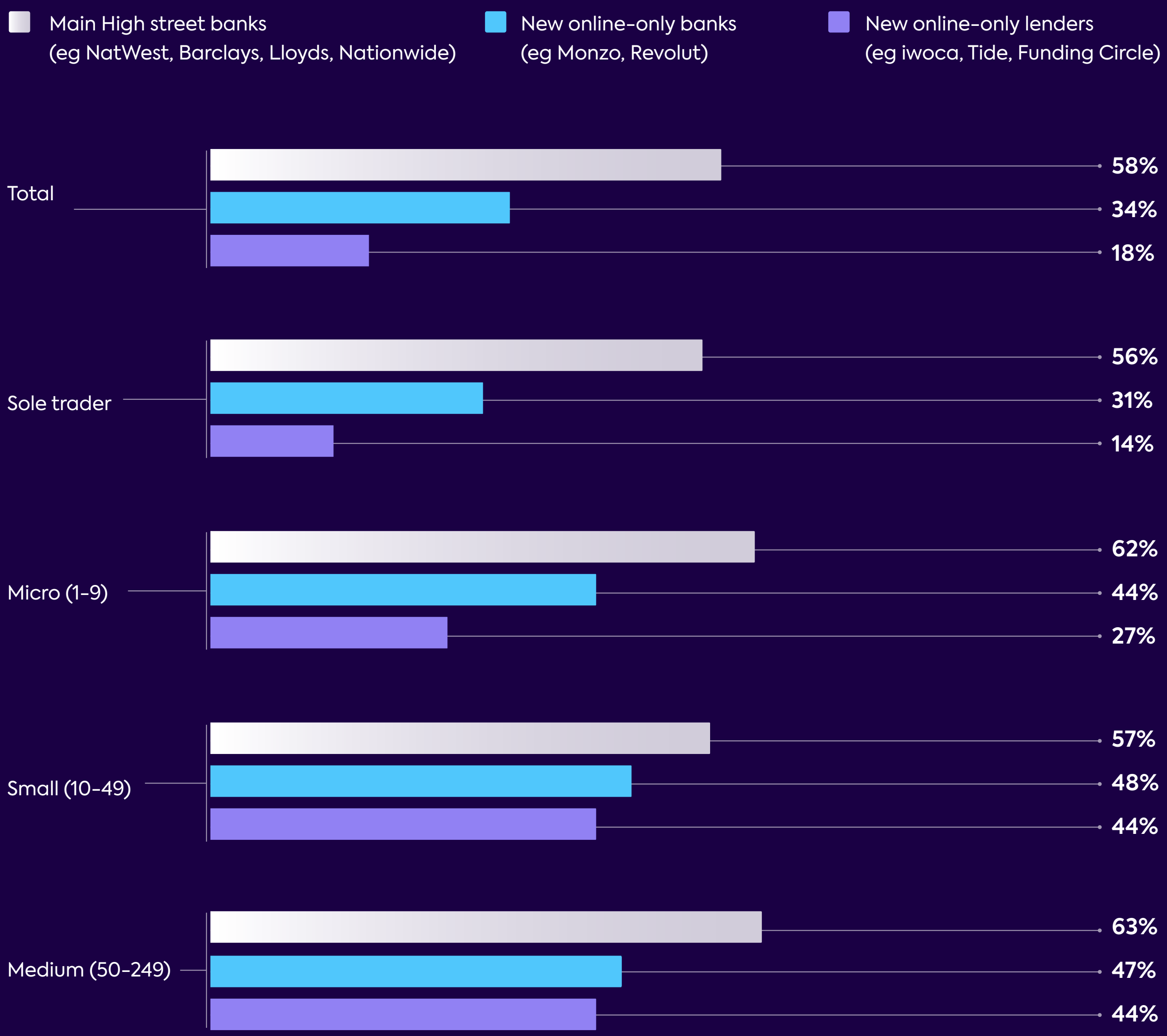
Compounding the effort it takes to apply a second time and the high chances of rejection, is a lack of accessible information — 18% of SMEs don't know where to get information on securing external finance.

They are unaware of alternative options

Our research shows that awareness of alternative lending options is low; a minority (37%) of potential borrowers have heard of alternative lenders.

Seemingly, alongside a lack of awareness comes a lack of trust. Looking at levels of trust, 58% of these small businesses trust their high street bank, yet less than a fifth (18%) trust new online-only lenders.

SME TRUST IN FINANCIAL INSTITUTIONS



Q: For each one, please indicate how much you trust that type of institution to do what is right. Nine point scale, net top 4 box. All potential borrowers' (791)

The lack of awareness is a key element to be addressed because increased awareness can lead to increased trust, which will open up more credit opportunities for SMEs.

Potential borrowers are understandably reluctant to shop around for funding, which leads to the lack of diversity in provider consideration. If their application is unsuccessful, this means the end of the road for most.

The lender perspective

The latest SME Finance Monitor found that over the last 12 months, 8% of SMEs (equivalent to 446,000 businesses)[3] had a need for funding, and the rate of credit application rejection was 25%.

2022 SME Finance Monitor data tells us that 63% of those with a need for funding go on to submit an application, which equals 280,000 businesses. A quarter of the applications submitted by those businesses were rejected.

Interestingly, the rate of rejection in Q4 2021 was significantly lower at 15% and it was 12% in 2020.

While that still represents a sizable portion of loan applications, it's worth noting that the rejection rate dropped significantly as a result of new government-backed schemes, brought into place due to the pandemic.

Pre-pandemic in Q4 2019, the rejection rate across all finance applications was sitting at 21%[6]. In 'normal' times therefore, we're looking at around a quarter of SME loan applications being rejected.

Why are lenders rejecting applications?

In 2021, the top reasons for unsuccessful applications were:

The provider thought it was unaffordable for the business	16%
The applicant lacked a track record	11%
The provider didn't think the applicant's business performance was strong enough	10%
The applicant had credit issues	5%
The applicant was not given a reason	6%

Q: What reason was given by the provider for the declined application? According to SMEs. SME Finance Monitor

Lenders lack the level of insight required to judge risk and affordability correctly. As a result, they don't know if the applicant can afford the loan, and they don't have up-to-date clarity on the business's financial performance. Ultimately, this lack of insight leads to a higher rate of unsuccessful applications.

> "**It starts with the data.** The better your data, the smarter your underwriting, the lower your loss rate, and the more extensive and affordable your capital solutions. But getting all that data off the ground is really hard to do."

Jim Cummings, COO of credit provider Ampla

> “We’ve traditionally had to **oversee ratios and metrics calculations** that are fed into our scoring engine. As financial reports are often erroneous and mis-categorised, this resulted in discrepant scoring and, ultimately, customer loss.”
>
> **Dan Shapir,** CTO & Co-Founder of mortgage lender Precise Finance

On top of this, the reality is that underwriting loans isn’t always affordable for lenders. Because the total revenue generated from each business loan is small, they can only assign a finite amount of resource to servicing that loan.

We have mapped out a model of bank’s unit economics to show the costs associated with providing a standard SME loan. It’s important to note that this model is purely illustrative and relies on assumptions which, while reasonable, are based on research and ultimately estimates. The calculation excludes upfront fees, acquisition costs (sales and marketing), and allocated overhead expenses.

ILLUSTRATIVE EXAMPLE OF THE COST TO SERVICE A £50,000 SME LOAN

Loan amount	**£50,000**
Interest income	**£5,000**
Cost of funding	**-£500**
Net interest margin	**£4,500**
Underwriting costs	**-£1,500**
Servicing costs	**-£1,000**
Loan loss provision	**-£1,500**
Net income before tax	**£500**
Taxes	**-£135**
Net income	**£365**
% of net interest margin	**8.1%**
Regulatory equity	**£6,250**
Return on equity	**5.8%**

The path forward: An SME Funding Passport

The overall issues with SME access to finance are:

- **Difficulty applying due to an unfriendly and fundamentally outdated system**
- **Lenders not having access to accurate data to make informed decisions**
- **A high rate of rejection**
- **A lack of secondary credit options caused in part by a minimal awareness of and trust in alternative lenders**

These problems can be solved with an updated approach to data portability and open data within the SME credit ecosystem.

As an extension of Open Banking and a move towards a more all-encompassing Open Finance[4], an SME Funding Passport will take the concept of more open data sharing and apply it to solving the challenges faced by SMEs in securing external finance.

What is an SME Funding Passport and how will it help?

An SME Funding Passport is a digital file containing company financial data necessary for underwriting. The data within this digital file is consented, standardised, and easily shareable with lenders in real time.

This goes beyond just bank account data and includes (but is not limited to):

- **Bank statements**
- **Financial statements**
- **Alternative data such as sales transactions and tax files**
- **Filed Companies House accounts and certificates**
- **Directors' KYC information**

Sharing data instantly with multiple financial service providers will:

- Enable SMEs to connect to more diverse and competitive sources of finance
- Increase the chances of securing the finance their business needs, quickly and simply

How will an SME Funding Passport solve the funding gap?

A solution for SMEs

The idea behind an SME Funding Passport is to use data portability to make it far quicker, easier, and fairer for small businesses to secure the finance they need to maximise productivity and growth.

A standardised, portable credit file will address the causes of the funding gap in the following ways.

1. Making the application process faster and more transparent for borrowers

Existing loan applications are manual and paper-heavy. It can often take up to six weeks for an SME just to get a loan quote.

Submitting data digitally cuts down the time taken to apply from weeks to minutes. Standardised, real-time data allows lenders to process applications far quicker and make faster, more informed decisions.

This will also improve transparency. Borrowers will know exactly what data the banks are basing their risk assessment on and will have confidence that it represents the most up-to-date view of their business's finances.

2. Making it easier for borrowers to submit multiple applications with different providers

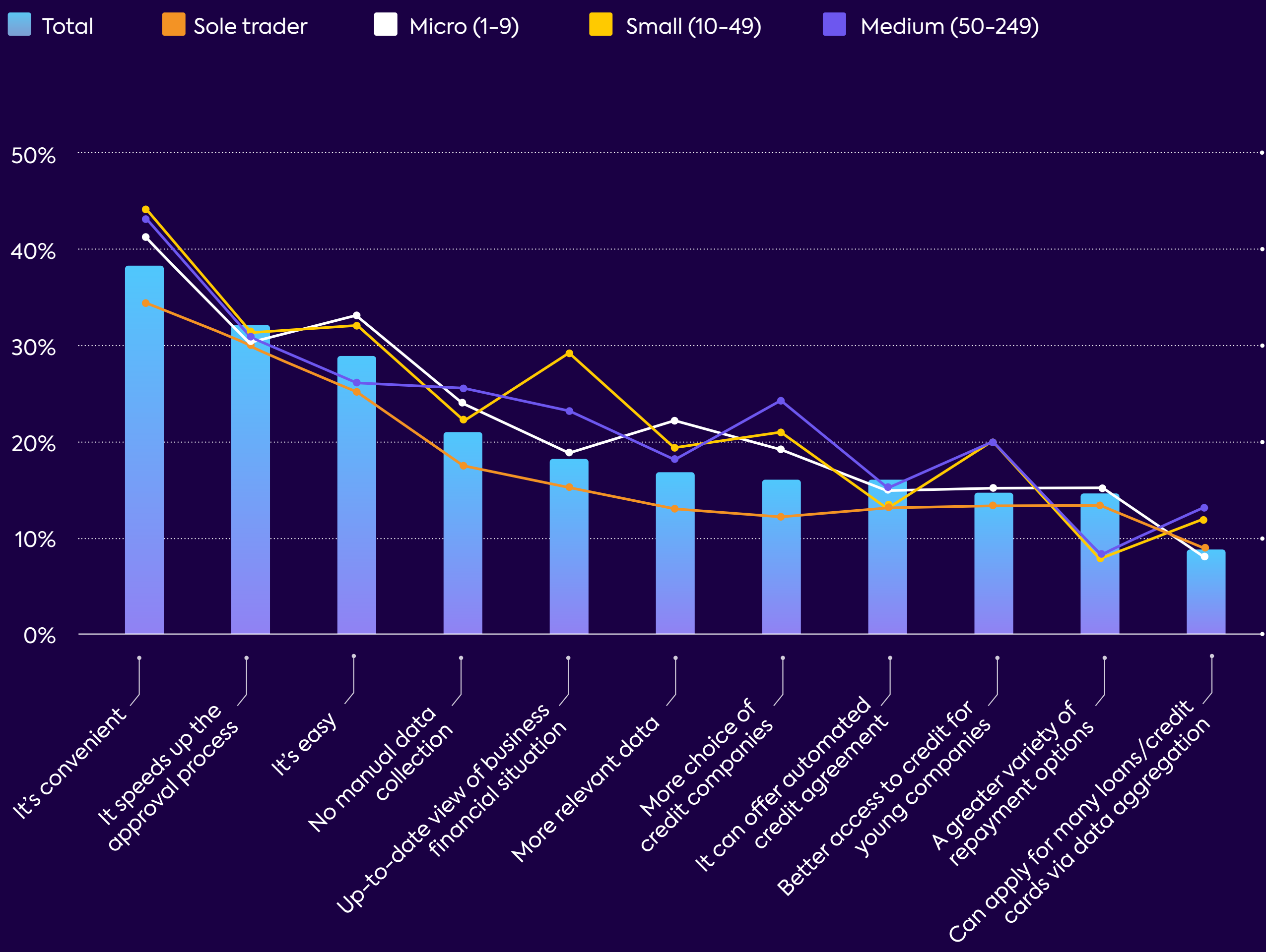
With a standardised SME Funding Passport, applicants will not need to regather and resubmit their documents and data to resubmit an application. It will simply be a case of consenting to share a predetermined selection of data points with the lender in question.

3. Cutting the cost for lenders to serve SMEs

An SME Funding Passport removes the need for lenders to manually collect, standardise, verify, and analyse decisioning data. More comprehensive, up-to-date information on SME prospects gives lenders more insight and minimises the risk of defaults.

This reduces underwriting and servicing costs, increasing profitability by almost 2x.

SMALL BUSINESSES' PERCEIVED BENEFITS OF OPEN FINANCE



Q: Here are a list of the potential benefits if the finance industry were to adopt this new way to assess businesses and deliver credit. Which of these do you find appealing? Base: All potential borrowers (787 / 270 / 203 / 214 / 100)

→ See appendix on page 38 for full data breakdown

These benefits align with those which SMEs themselves see as the most potentially appealing to come from data sharing and Open Finance implementation in the context of credit access.

Overall, 70% of potential borrowers find the features of Open Finance appealing, when used to manage the way business credit is delivered. A smoother process is the most popular (58%), followed by more confidence in the decisioning (36%) and better products (27%).

A solution for lenders and the economy

Improved data portability for small business loan underwriting is a win-win. It's not just small businesses that will benefit.

Lenders will benefit from faster, less complex, less risky decisioning that will be powered by easy and permissioned access to accurate, relevant, standardised, and verified data.

Our economic modelling estimates a 1.95x increase in profitability with the implementation of an SME Funding Passport — fueled by a significant decrease in underwriting and servicing costs.

The graph compares the costs of servicing a standard SME loan with and without a Funding Passport in place. As with our loan model featured earlier in the report, this is purely for illustrative purposes.

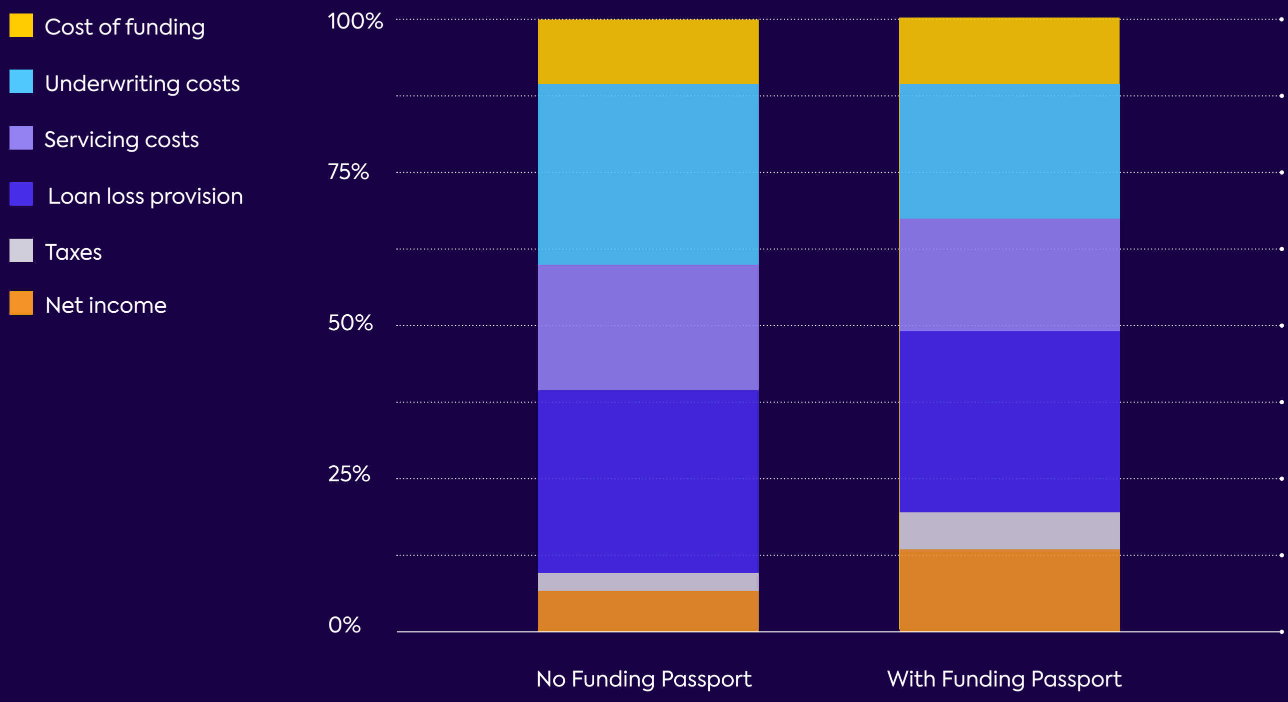
ILLUSTRATIVE EXAMPLE OF THE COST TO SERVICE A £50,000 SME LOAN WITH AND WITHOUT AN SME FUNDING PASSPORT

	No Funding Passport	With Funding Passport
	Scenario 1	**Scenario 2**
Loan amount	**£50,000**	**£50,000**
Interest income	£5,000	£5,000
Cost of funding	-£500	-£500
Net interest margin	**£4,500**	**£4,500**
Underwriting costs	-£1,500	-£1,125*
Servicing costs	-£1,000	-£900**
Loan loss provision	-£1,500	-£1,500
Net income before tax	**£500**	**£975**
Taxes	-£135	-£263
Net income	**£365**	**£712**
% of net interest margin	8.1%	15.8%
Regulatory equity	£6,250	£6,250
Return on equity	**5.8%**	**11.4%**

1.95x
Increase in Profitability

* Estimated underwriting officer salary & time spent per new loan. 25% reduction in time spent per new loan.
**Estimated servicing officer salary & time allocated per loan. 10% reduction in time spent per loan serviced.

THE FINANCIAL BREAKDOWN OF SERVICING A £50,000 LOAN WITH AND WITHOUT AN SME FUNDING PASSPORT



The 5.6 million SMEs in the UK vary hugely in size, industry, and scope — as do the tools they use and therefore the data points they create. Progressing towards an SME Funding Passport will enable lenders to access a much wider variety of data points and increase their potential to underwrite loans for a far broader segment of SMEs.

SMEs being able to access more credit from a wider pool of lenders, and lenders having the tools to underwrite a larger number of SMEs in a more efficient way, will be a huge step towards narrowing the £22bn funding gap.

As economic troubles worsen across the UK and business cash flows feel the pinch, there will be an incalculable value in reducing barriers to SME credit. Initially helping small businesses weather the storm and subsequently having the infrastructure in place for them to operate as productively as possible and grow, is an open goal for boosting the economy.

Why an SME Funding Passport will work

Are SMEs happy to share their data?

In short, yes. But there are some caveats.

Two thirds (67%) of potential borrowers would be willing to share data with potential credit suppliers. This increases to 90% for those SMEs with more than 10 employees.

When it comes to the best incentives for sharing business financial data, better rates on loans is the most popular, selected by 29% of SMEs, followed by more transparency in decision making, chosen by 22%.

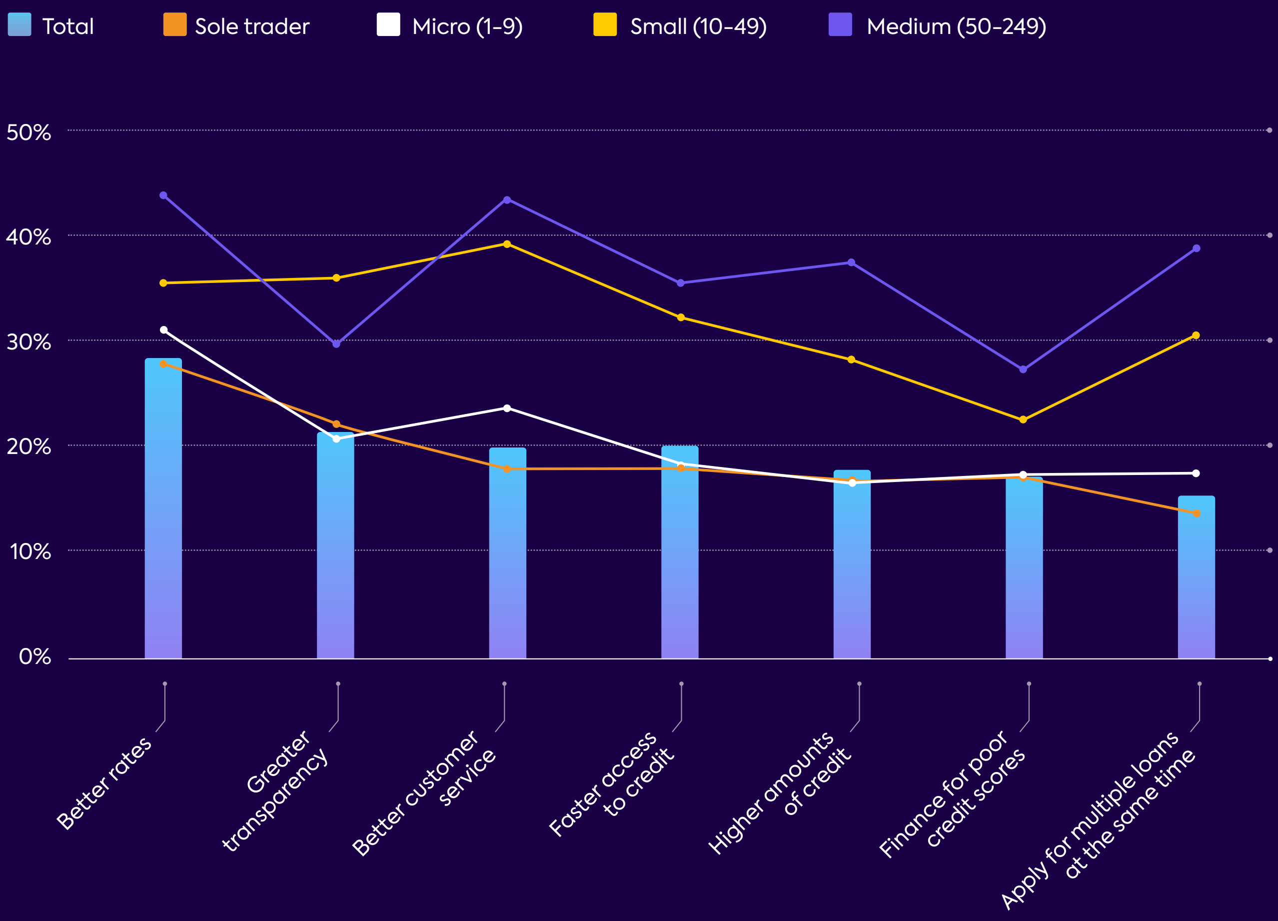
Attitudes to sharing financial data in return for access to better lending products and services — such as better rates and quicker service — vary significantly between different sizes of SME. The appeal grows along with business size.

Only 19% of sole traders find the value exchange of faster access to credit in return for data appealing. Among micro businesses (1-9 employees), that number increases to 38% and continues to grow to 61% and 70% for small (10-49 employees) and medium (50-249 employees) companies respectively.

90%

of SMEs with more than 10 employees are willing to share their data with lenders

SME DRIVERS TO SHARE MORE DATA



Q Which of the following, if any, would be an incentive to you to share your business data? Absolutely
Base: All potential borrowers (787 / 270 / 203 / 214 / 100)

→ See appendix on page 39 for full data breakdown

This is good news for the economy. Solving the issue of access to credit for small and medium businesses is key because they contribute significantly more to GDP than micro businesses. Companies with over 10 staff represent 5% of all businesses, but contribute 31% of turnover in the economy.

And, over half (52%) of these SMEs feel it's worthwhile to share their data if they are likely to apply for credit in the short term.

The key takeaway here is that SMEs are open to sharing their data in return for improved lending products — namely better rates. The appeal of data sharing grows with business size and is correlated with an immediate interest in accessing credit. This makes sense — motivation to share data for better lending products will naturally be lower when a lending product isn't an imminent business requirement.

What impact would an SME Funding Passport have?

Small businesses are open to sharing their data and would change their borrowing behaviour if a Funding Passport were in place.

Just over half (51%) of potential borrowers would change their approach to funding. This increases to 84% of small businesses (10–49 staff) and 93% for medium businesses (50–249 staff).

Of those that would change their approach to funding:

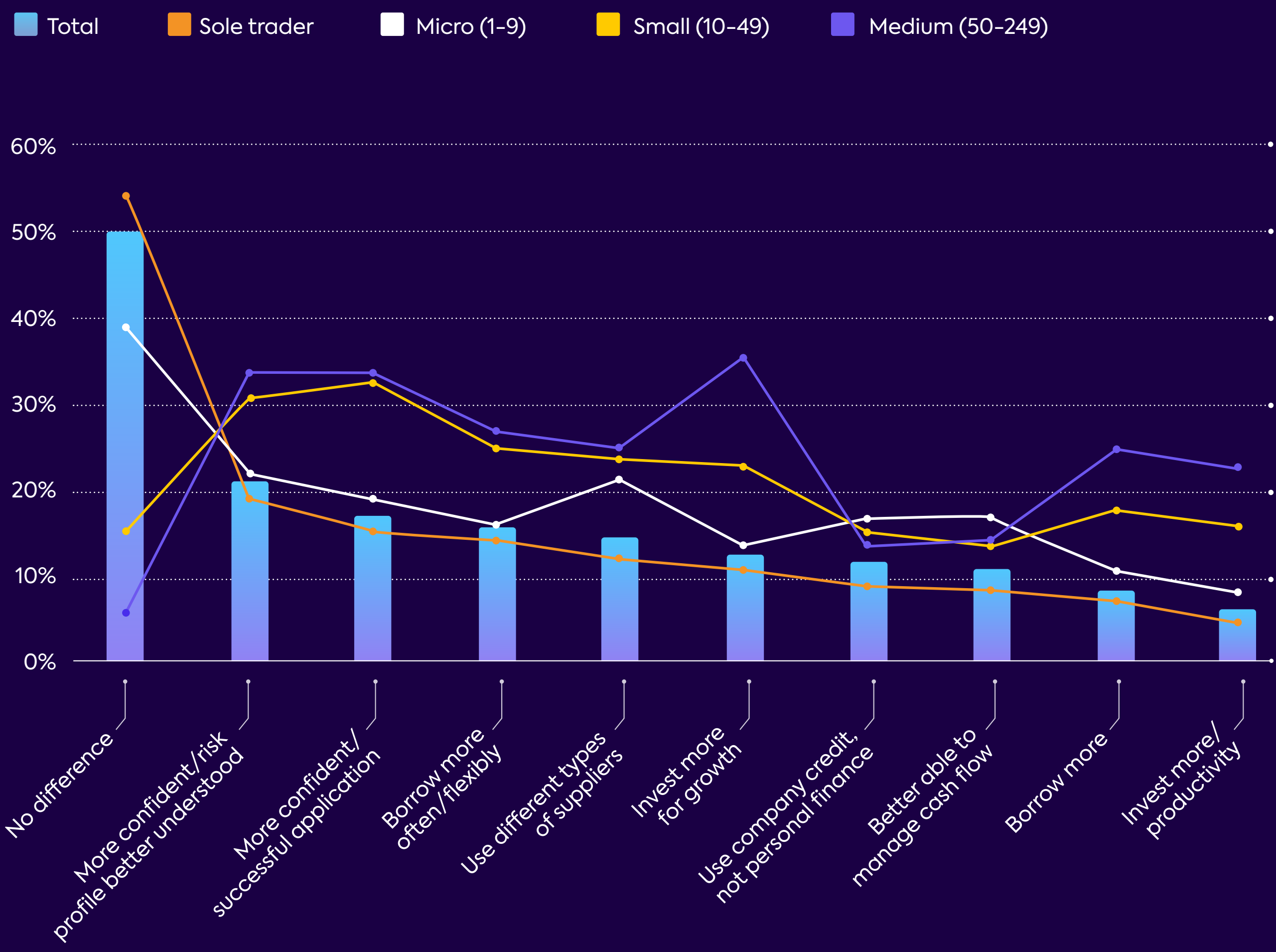
42%	would have more confidence that their risk profile was properly understood
35%	would be more confident that their application would be successful
31%	would borrow more often
30%	would approach different lenders
18%	would borrow more
15%	would invest more towards productivity

The impact would also be felt in terms of business health and growth:

26%	would invest more for growth
22%	believe an SME Funding Passport would give them better cash flow management
15%	would invest more towards productivity

51% of SMEs would change their approach to borrowing if a Funding Passport were available

HOW SMES THINK A FUNDING PASSPORT WOULD IMPACT THEIR BUSINESS



Q: Thinking about if you were to have a Funding Passport, it was all set up and working, how do you think it would change the way you approach credit?
Base: All potential borrowers (787 / 270 / 203 / 214 / 100)

→ See appendix on page 40 for full data breakdown

This tells us that there would be a real-world impact from the existence of a standardised credit file used for helping SMEs access credit.

SMEs would borrow more and more often, would approach alternative lenders, and, as a result, would be able to invest more in their own operations to improve growth. Importantly, the sentiment around SME credit would improve too with increased confidence in the applications side of the process.

Background to the SME Funding Passport

The idea of a standardised credit file for SMEs is not new. Two years after the initiation of Open Banking in 2017, the idea behind a Funding Passport was born.

2019

20 June

The former Governor of the Bank of England highlights the £22bn SME funding gap. "Putting data to work is critical to closing one of the biggest funding gaps in the country."

The Bank of England's *Future of Finance Review* is published.

June

The Bank of England proposes an Open Data Platform, to empower small businesses and individuals to harness the power of their data to improve access to finance.

August

The Bank of England supports the use of Legal Entity Identifiers (LEIs) as a way to deliver greater transparency on the identity of entities in financial markets. "Widespread adoption could help make it more efficient for businesses to access finance, credit and other services."

December

FCA issues a call for input on Open Finance.

2020

March

The Bank of England's *Open Data for SME Finance report* **is published.**

October

FCA call for input on Open Finance **closes.**

2021

Spring

Smart Data Working Group report released by the Department for BEIS. The Government commits to introducing legislation as soon as parliamentary time allows so that "SMEs can take advantage of the benefits of data sharing similar to those already being delivered by Open Banking."

March

Results from the FCA's call for input on Open Finance published — SMEs could significantly benefit from Open Finance, with increased access to credit.

2022

May

King Charles announces **the Data Reform Bill** in the Queen's speech.

June

Details of the Data Reform Bill are announced — with no specific mention of improving SME access to credit.

How will a Funding Passport work?

At the time of writing, developments with the Data Reform Bill[5] are the latest thing to have happened in this regulatory sequence. In short, this means that there is nothing yet in place to improve SME access to credit after three years of proposals and consultations.

The idea of an SME Funding Passport is not new. Now, the stage is set to make some meaningful headway.

The framework and legislation via which an SME Funding Passport will work requires building out, although it must be underpinned by some key concepts.

The legislation

Legislation must mandate that SMEs can access and share their data from all their connected data sources such as banks, accounting platforms and payments platforms, within a reasonable timeframe that benefits the SME.

The openness of these data sources is paramount to the effectiveness of an SME Funding Passport.

Legislation to this effect would ensure that SMEs have the control over their own data and can leverage it to grow their business in the way they choose.

The data

The SME data shared with lenders via an SME Funding Passport must be:

- Standardised
- Verified
- Consented
- Relevant to lenders

The SME Funding Passport will cover a set of core components and data points that are required in most credit underwriting decisions:

- Filed accounts on Companies House to give them an overview of the business
- **24 months** worth of financial statements to help them understand the health of the company
- **3-12 months** worth of bank statements to help them verify the financial data

In addition to the core components, optional modules will enable the UK's diverse range of SMEs to bolt on necessary tranches of data relevant to them and their specific application. For example, it could be useful for an Amazon merchant to be able to make their commerce data available to a lender.

What needs to happen now?

The Data Information and Protection Bill sets a precedent for the UK's approach to smart data. Parliament must support it, inclusive of amendments which take into consideration the needs of SMEs as well as consumers.

Alongside this, the industry must continue to build further consensus on the best way to support SME access to credit. An SME Funding Passport must be a clear next step after the implementation of the Data Bill.

If these ideas align with your own, please register your interest to keep up to speed with Codat's latest work in this area.

Appendix

1: SME sizes

Within the scope of the research into the SME funding landscape carried out by Codat, SME sizes are defined as:

- Sole trader
- Micro business (1-9 employees)
- Small business (10-49 employees)
- Medium business (50-249 employees)

2: PNB

A 'permanent non-borrower' is defined by the BVA BDRC SME Finance Monitor as:

"SMEs that seem firmly disinclined to borrow because they meet all of the following conditions: are not currently using external finance, have not used external finance in the past 5 years, have had no borrowing events in the past 12 months, have not applied for any other forms of finance in the last 12 months, said that they had had no desire to borrow in the past 12 months and reported no inclination to borrow in the next 3 months."

3: Number of UK SMEs

The number of SMEs in the UK in 2021 was 5.6 million, according to the House of Commons Library Business Statistics

4: Open Finance

As defined by the Financial Conduct Authority: "Open Finance is an opportunity to build on the concept of Open Banking and allow consumers and SMEs to access and share their data with third-party providers (TPPs).

"Open Finance involves extending Open Banking-like data sharing and third-party access to a wider range of financial sectors and products. It is based on the principle that financial services customers own and control both the data they supply and which is created on their behalf."

5: Data Reform Bill

The Data Protection and Digital Information Bill. First read on the 18th of July 2022.

6: Rejection rate data

In the most recent application period (Q1 2021 to Q2 2022) 25% of applications were declined, up from 15% for applications made between Q3 2020 and Q4 2021 and 12% in applications made between Q1 2020 and Q2 2021.

REASONS NOT TO BORROW AMONG SMES

	Total	Net: Sole trader	Net: Micro (1-9 emp)	Net: Small (10-49 emp)
Unweighted base	423	210	113	75
Weighted base	573	448	116	8
We don't need to borrow / borrow more	**53%**	**48%**	**71%**	**60%**
I don't like being in debt	**46%**	**49%**	**36%**	**19%**
We don't need to invest in the business	**39%**	**41%**	**36%**	**21%**
We don't want to borrow (more) in the current economic climate	**35%**	**37%**	**27%**	**33%**
I think the bank would say no	**9%**	**10%**	**4%**	**4%**
I see it as a failure having to borrow money for the business, we should create wealth to invest	**6%**	**7%**	**5%**	**5%**
We can borrow from family and friends if needed	**10%**	**5%**	**6%**	**1%**
We are already borrowing as much as we can	**3%**	**3%**	**4%**	**11%**
We have a bad credit score	**2%**	**2%**	**1%**	**1%**
I find the bank forms and literature too off-putting	**1%**	**1%**	**-**	**1%**
There's a County Court Judgement against the business owner	**0**	**0**	**-**	**-**
Religious reasons for you / the business owner	**0**	**-**	**0**	**-**

NB: Mid-sized companies base size was too small (25) to analyse data separately, although data is included in 'total'
Q: Which of the following are reasons you will not apply for credit? Base: All respondents unlikely to apply for external finance

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PERCEPTIONS OF FINANCE CURRENTLY AVAILABLE

	Total	Net: Sole trader	Net: Micro (1-9 emp)	Net: Small (10-49 emp)	Net: Medium (50-249 emp)
Unweighted base	791	271	205	214	101
Weighted base	792	578	182	23	8
It's expensive	39%	38%	44%	43%	35%
It's hard to get	33%	33%	33%	27%	30%
It's complex	26%	27%	21%	23%	27%
It's intimidating	14%	16%	9%	11%	16%
It's slow	13%	11%	18%	16%	26%
The repayment options make it hard for my business to repay finance	12%	11%	15%	14%	20%
Decisions are made based on out-of-date information	12%	12%	11%	15%	19%
There isn't much choice, all the products look the same	12%	11%	13%	14%	17%
It's convenient	8%	8%	7%	14%	15%
It's easy	8%	8%	7%	11%	12%
Lots of choice	7%	8%	7%	7%	13%
It's good enough	6%	5%	8%	11%	10%
There's great customer service	2%	2%	2%	6%	8%

Q: Which of the following do you agree with when it comes to the financing currently available to small and medium-sized businesses (SMEs), whether you use it personally or not. Base: All potential borrowers

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SMALL BUSINESSES' PERCEIVED BENEFITS OF OPEN FINANCE

	Total	Net: Sole trader	Net: Micro (1-9 emp)	Net: Small (10-49 emp)	Net: Medium (50-249 emp)
Unweighted base	787	270	203	214	100
Weighted base	790	578	181	23	8
It's convenient	**38%**	**36%**	**43%**	**46%**	**45%**
It speeds up the approval process	**32%**	**32%**	**32%**	**33%**	**33%**
It's easy	**29%**	**27%**	**35%**	**34%**	**28%**
No manual collection of data to send to a lender	**21%**	**19%**	**26%**	**24%**	**27%**
A more up-to-date view of the financial situation of your business	**19%**	**17%**	**21%**	**31%**	**25%**
It uses more relevant data for your business	**17%**	**15%**	**24%**	**20%**	**19%**
More choice of credit companies	**16%**	**14%**	**21%**	**23%**	**26%**
It can offer automated credit agreement	**16%**	**15%**	**17%**	**15%**	**17%**
Better access to credit for young companies	**15%**	**14%**	**16%**	**22%**	**22%**
A greater variety of repayment options	**15%**	**14%**	**16%**	**10%**	**10%**
You could apply for many loans / credit cards at once using the most relevant data through aggregators	**9%**	**9%**	**8%**	**14%**	**15%**

Q: Here is a list of the potential benefits if the finance industry were to adopt this new way to assess businesses and deliver credit. Which of these do you find appealing? Base: All potential borrowers

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SME DRIVERS TO SHARE MORE DATA

	Total	Net: Sole trader	Net: Micro (1-9 emp)	Net: Small (10-49 emp)	Net: Medium (50-249 emp)
Unweighted base	787	270	203	214	100
Weighted base	790	578	181	23	8
Better rates	**29%**	**28%**	**31%**	**36%**	**44%**
Greater transparency	**22%**	**22%**	**21%**	**36%**	**30%**
Better customer service	**20%**	**18%**	**24%**	**40%**	**44%**
Faster access to credit	**20%**	**19%**	**19%**	**33%**	**36%**
Higher amounts of credit	**18%**	**17%**	**17%**	**29%**	**38%**
Poor credit scores	**18%**	**18%**	**18%**	**23%**	**28%**
Apply for multiple loans at the same time	**16%**	**14%**	**18%**	**31%**	**39%**

Q: Which of the following, if any, would be an incentive to you to share your business data? (response: Absolutely). Base: All potential borrowers

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HOW SMES THINK A FUNDING PASSPORT WOULD IMPACT THEIR BUSINESS

	Total	Net: Sole trader	Net: Micro (1-9 emp)	Net: Small (10-49 emp)	Net: Medium (50-249 emp)
Unweighted base	787	270	203	214	100
Weighted base	790	578	181	23	8
Feel more confident that your risk profile was better understood	**21%**	**20%**	**23%**	**31%**	**34%**
Feel more confident that the business would be successful with an application	**17%**	**16%**	**21%**	**33%**	**34%**
Borrow more often / more flexibly	**16%**	**15%**	**17%**	**26%**	**27%**
Approach different types of suppliers	**15%**	**13%**	**22%**	**24%**	**26%**
Invest more for growth	**13%**	**12%**	**14%**	**23%**	**36%**
Use company credit rather than take on personal finance	**12%**	**10%**	**17%**	**16%**	**14%**
Be better able to manage cash flow	**11%**	**9%**	**17%**	**14%**	**15%**
Borrow more	**9%**	**8%**	**12%**	**18%**	**25%**
Invest more for better productivity	**7%**	**6%**	**9%**	**16%**	**23%**

Q: Thinking about if you were to have a Funding Passport, it was all set up and working,
how do you think it would change the way you approach credit? Base: All potential borrowers

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About Codat

Codat is the universal API for small business data

We connect fintechs and financial institutions to the platforms their SME customers use—including accounting, banking, and commerce systems—to help them to build smarter, more integrated products.

Our API is used to power technology for credit underwriting, accounting automation, and business financial management. It is trusted by more than 250 clients globally, from payment providers, corporate cards, and SaaS companies to tier one banks and digital lenders.

To learn more about our platform, contact a member of our team or visit our website.

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