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Business

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Out of Africa comes an idea that can help to solve Britain's small business lending crisis

"The slums and shambas of East Africa are not an obvious place to find a solution to Britain's small business lending crisis but, under those corrugated iron roofs, a quiet revolution is taking place. The blueprint is M-Kopa, a local outfit that sells solar energy-powered kit to the rural poor.

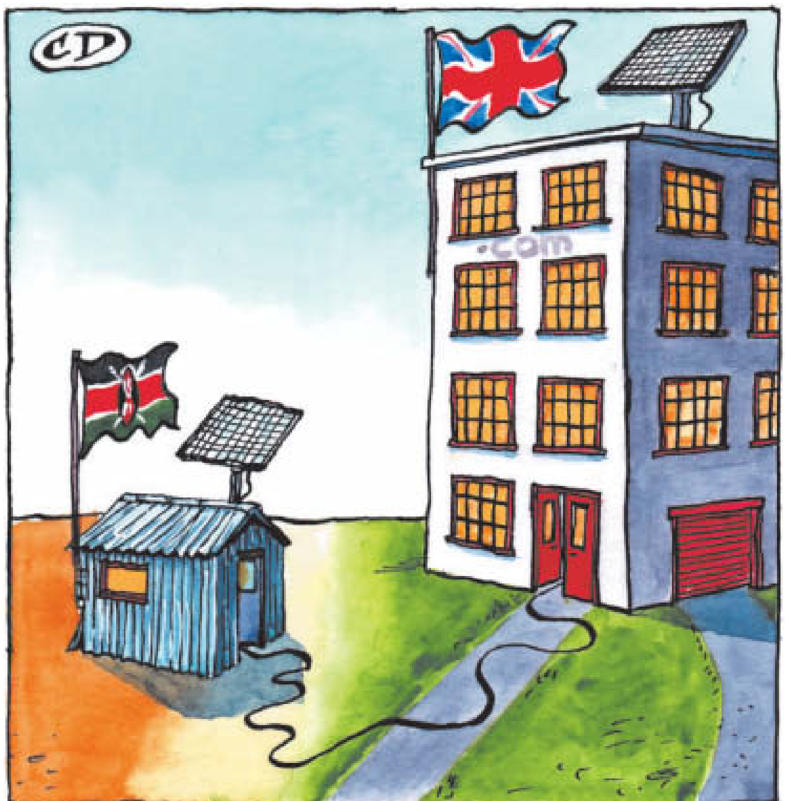
Energy is a big expense for those living off-grid in Kenya. According to a 2014 survey, the average household expenditure was about £250 a year on mobile phone charging, batteries and kerosene for lamp lights.

M-Kopa claims its kit, a solar panel with lithium battery, radio, LED bulbs, torch and phone cables, can save customers money. The catch is that the outlay is far more than an average household can afford. So M-Kopa takes payment in daily 40p instalments (*kopa* means borrow in Swahili).

Nothing here is revolutionary, it's like car finance, but what happens next is interesting. Payments are made by mobile phone, using the widespread M-Pesa cash transfer service, and in doing so M-Kopa starts building a digital credit record of its customers. That credit history in turn becomes a valuable asset, giving households access to other financial services such as loans. Algorithms and mobiles are helping end financial exclusion for the unbanked poor.

So what does an African solar powered microfinance business have to do with the UK? Well, arguably, small businesses are Britain's unbanked. They have deposit accounts, of course, but they don't borrow — debt levels have been shrinking — and if they don't borrow, they don't grow. What makes that a crisis is that if they don't grow, neither does Britain. Small businesses account for two thirds of private sector jobs and a fifth of GDP.

Between 2013 and 2017, lending to small and medium sized businesses fell 7 per cent to £93 billion, according to UK Finance, despite the number of small businesses expanding. Within that, lending to the smallest companies fell 39 per cent to £7.2 billion. There has been a "shift from credit crisis to credit apathy" in the past decade because small firms no longer want to take out a loan, the British Chambers of Commerce says. Companies either don't think they will qualify for one, founders don't want to put their home up as collateral or they just balk at the complexity of the process.



The Borrowers

Peter Rice, a former banker who runs Clearpoint advisers and is working with the Labour Party, says retail banking culture is a big obstacle. Banks seek cost efficiencies, growing profit by cutting staff and automating more. In that context, mortgages are the perfect product. They are uncomplicated and, backed by a solid asset, relatively safe. Small business lending is complicated and risky. One banker can have 30 to 40 small company clients, Mr Rice says, but do ten times as much mortgage lending.

This is where fintech, the fusion between finance and technology pioneered in Africa with M-Pesa, comes in. Companies like Ezbob, which has signed deals with American Express and RBS, are using digital footprints, like those left by M-Kopa clients, to speed up small business loan applications. Online business and personal information is cross-referenced against ecommerce platforms, online marketplaces and payment providers and a credit file is generated within minutes. It can cut costs by up to 80 per cent.

The Bank of England has big ambitions for fintech in this area. A trove of data can be found at Companies House, DVLA, the Passport Office and other official sources which could be brought together with transaction data held by the likes of Amazon, Etsy or Ebay to build comprehensive credit profiles. Doing so could automate much more small business banking, removing the cost and efficiency obstacle for traditional lenders.

But there is another barrier. Banks like physical collateral to hold against loans, it makes them feel protected, and property is great collateral, which is one reason why mortgages are such a popular loan. Regulation reinforces that bias by making mortgages less expensive for banks, in terms of the cost of capital, than other forms of lending. A lack of physical collateral threatens to become an even worse problem because small businesses are increasingly selling services, which means their assets are intangible.

In that new world, a solid credit profile built on a clear track record and smart analytics, like M-Kopa customers, will be essential. Africa is not the only developing market leading the way here. Alibaba (China's Amazon and Ebay) and Baidu (China's Google) already make swift credit decisions based on customer data and sales records. Between them, they provide a tenth of the credit to the Chinese small business market.

In Britain, the new banks Starling, Metro and Clearbank will get £280 million of the £775 million RBS had to set aside for small business lending under state aid rules. Peer-to-peer lending will be part of the solution, too. But access to affordable loans starts with the credit profile.

Labour has other plans. It does not trust markets to solve a market failure, with good reason. Instead, it is focused on "credit guidance", mandating the Bank to direct lending into productive areas of the economy. By raising the cost of capital on mortgages and lowering it for small businesses, banks would make more profit by lending to start-ups. Nowhere does money talk louder than in the City.

The idea makes a lot of sense. Bank loans to households total £1.34 trillion, about £65 billion more than their deposits. Rather than using consumers to finance growth-enhancing businesses, business deposits are being used to finance unproductive, speculative property punts. It's the wrong way round and, as much as the Bank claims regulation is about financial stability, that is the "stability of the graveyard", as George Osborne put it. Growth is suffering because policy is passively funnelling credit the wrong way.

Venture capital is flinging money at tech start-ups but access to finance for less on-trend firms is moribund, sucking ambition and energy from the young businesses that should be Britain's future. Fintech can be part of the solution, as can credit guidance. There's no shortage of ideas. But will anyone deliver?"

Philip Aldrick is Economics Editor of The Times