We’re over the overdraft: Why it’s high time we saw lending that works for, not against, SMEs

From the UK to Europe and beyond, small businesses are struggling. Rising inflation and energy prices are increasing their costs, and consumers - facing the same cost of living pressures - aren’t spending enough to balance out the books. So what does this mean for these SMEs and their owners?

They’re stuck relying on unsustainable funding solutions – like credit cards and overdrafts – that are at best one-size-fits-all, and at worst, simply not fit for purpose.

It’s time we stopped treating businesses like students and started treating them like the grown-ups and innovators they are: and fintech can step in to help with realistic, tailored options.

Why SMEs need extra cash – now!

Small business owners are facing *rising input inflation* (an increase in prices of materials and fuels bought by manufacturers) and energy costs, while consumers are reducing their spending at the same time. Although the spring budget is set to bring small solace in the form of *an extension to the energy price guarantee*, any attempts to cull inflation will kick in far from immediately. At the same time, many small businesses are still struggling with the supply chain issues that began during Covid and have been exacerbated by the invasion of Ukraine.

It’s no wonder, then, *that 92% of UK startups* and small businesses are already fearful about their future prospects. Price hikes of some commodities plus unfavourable exchange rates have already forced *over 40% of SMEs to close*. This plummeting confidence is causing businesses to prioritise protection over growth – in fact, *the number of companies planning to expand has halved* this year compared to summer 2022.

Overdrafts: Not a saviour for SMEs

As they attempt to reduce overheads to ride out the cost of living storm, business owners can’t afford to forget to look at their borrowing methods in parallel. Business overdraft reliance is at a *10-year high* – this would be bad news if inflation was within normal territory, but it’s even worse in the current context.

A default to this kind of quick-fix is understandable in an environment where SMEs are routinely overlooked when it comes to financing options. And it works very nicely for big-banks too – they get to keep on peddling out a blanket offering and raking in the resulting interest, rather than bothering to come up with a tailored solution that could actually help small businesses in the long term.

But the reality is, using a standard overdraft or credit card linked to their business account to access extra funds and smooth out cash flow problems will only plunge owners into more debt.

Interest rates on overdrafts are higher than on some other forms of lending, with the average sitting *around 10%*. Overdrafts often come with fees, too, which can quickly snowball to unmanageable levels if the agreed overdraft limit is overrun – leading to an even bigger problem than the one it’s supposed to solve in the first place.

There is just no need for small businesses to rely on poor funding solutions. We know that they make up *99% of all businesses in the UK* – so why aren’t financial institutions serving them better?

The alternative lending options SMEs need to know about

Luckily, we've figured out there's a better way to do SME finance. By being agile, abandoning tick-box approaches and taking a long-term view, we fintechs can provide alternative lending options that banks don't. In turn giving small businesses the financial freedom and stability they deserve at an essential time.

There are two ways to do that, which businesses themselves might not have considered yet – supply chain finance and invoice finance.

Supply chain finance

Supply chain finance allows businesses to lengthen supplier payment terms and gives them the option to get paid by customers early. This solution will help businesses who might be struggling to meet supplier invoices that cost a little more than usual or have short credit terms.

Invoice finance

Slow payment of invoices is one of the most common *reasons SMEs experience cash flow problem*s. Since all businesses are in the same boat during the cost of living crisis, one way to raise extra cash is lending based on the funds tied up in expected invoices. This will give businesses the liquidity to meet their obligations weeks or even months before they actually receive the payment for those invoices.

To truly future-proof their business, SMEs need to know about the other finance options out there which are just as agile as they are, allowing them to avoid the use of predatory overdrafts and steer clear of the red zone. This is important at any time, but in 2023 it's one of their best chances of surviving and, hopefully, thriving.

And in the meantime let's stop calling it alternative finance. This is not some niche, curveball option, and good service should not be considered radical. It's just genuine, tailored finance that works.

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