Access To Finance

On 11 November 2010, Venture Finance hosted a panel of corporate finance experts from banking, private equity and government, as well as the professional services and advisory sectors. Their task was to address how the finance industry can help Britain's small and medium-sized companies access the funds they need not only to survive and thrive but also to help sustain the UK's economic recovery

The recovery has been stronger than expected in 2010, and yet lending to SMEs remains subdued. In the opening ThinkTank session, our panel discussed the issues affecting access to finance in the current financial climate

Our ThinkTank panel gathered against a backdrop of cautious economic optimism. Official figures point to stronger than expected growth in the second and third quarters of 2010, clear retrospective evidence of a continuing recovery. Looking ahead, however, cuts in public spending and an imminent rise in VAT will only serve to rattle the economy.

As ThinkTank chairman Professor Nigel Waite pointed out, the coalition government's strategy to shrink the state extended beyond the immediate requirement to reduce Britain's public sector deficit. "A great deal has been said about the need to rebalance the economy away from growth and demand, which is driven by government spending on one hand and debt-fuelled consumer consumption on the other," said Professor Waite. "What is now in favour is growth based on business expansion and increasing our presence in export markets."

If the private sector is to maintain the momentum of Britain's recovery, then it is essential that small and medium-sized businesses (SMEs), generally recognised as the bedrock of the economy, can access the funds they need to not only cover their working capital requirements but also invest for future growth. Thus, the panel began their discussion by taking a detailed look at the availability of funds to that all-important SME sector.

Availability of finance

Headline figures suggest that SMEs are not well served at present. According to the British Bankers' Association, lending to non-financial businesses fell 5.6% in September, compared with the same period a year earlier. Meanwhile, Venture Finance's own annual Credit Check survey suggested that businesses are continuing to struggle for finance. Sixty percent of the accountants polled in the study said finance was barely available to SMEs, while 48% said unsecured company loans were completely unavailable.

These numbers beg some interesting questions. Are banks lending less because they can't lend or because they won't lend? Or is it a case of recession-hit businesses being reluctant to step-up their operations? Evidence suggests that demand for finance is currently subdued, at least in some quarters.

As Allan Laing, Chief Executive of Pentagon Chemicals (Holdings) Ltd, observed, businesses that have survived the recession aren't particularly inclined to intensify their operations at a time of continuing uncertainty. "I think that many SMEs are very cautious now about rebuilding and reinvesting in capital for new projects," he said. Kate Sharp, CEO of the Asset Based Finance Association, agreed. "Some companies are not utilising available funds," she said. "They are just waiting and seeing."

According to Jamie Young, Director of Feist Hedgethorne, a provider of part-time finance directors, the effects of the recession are still being felt. "I'm finding business pretty flat at the moment," he said. "Across my client-base, no one is in any particular financial trouble. But neither are they making outstanding profits and generating enough cash to invest in the future growth of the business."

The ThinkTank panel stressed that the recovery simply cannot be taken for granted, as the prospect of a double-dip recession continues to affect plans for borrowing and investment.

Unfulfilled demand

If the panel acknowledged that lower borrowing was to some degree due to lower demand from businesses, there was also an agreement that many businesses were struggling to access the funding they required to take advantage of the UK's possible return to sustained growth.

David Brockhurst, a senior manager in KPMG's Mid-Market Debt Advisory Group, argued that banks, which had been criticised for lending too freely before the financial crisis, were another example of natural caution. It would be wrong, he said, to blame them for reserving finance. David went on to identify the human aspect that also serves to reduce the prospect of liquidity. “Corporate centre managers are under all sorts of pressure that they may not have been under before, and are asked a lot of questions about their customer-base to which they may not have any immediate answers,” he said. Without access to such information, it is harder for financiers to make lending decisions, a factor that business owners may not always recognise.

Peter Ewen, Managing Director of Venture Finance, pointed out that trends in the banking industry had reduced contact between financiers and their clients. “As fees have been driven down it is much more difficult for traditional financial institutions to understand their clients as well as they did previously, simply because they have less people to do so,” he said. “They have to be more efficient because prices have been dropped. I do hope that we see a return to a focus on customer value as well as shareholder value,” he added.

The government’s role

The panel’s discussion on the availability of finance inevitably led to an assessment of the government’s recently extended flagship lending scheme, the Enterprise Finance Guarantee. Oliver Woolley of the British Business Angels Association expressed concern that the scheme was proving “elusive” to small firms. Peter Ewen said, “We are a supporter of the EFG, but my real feeling is that the government could have been more generous with it.” He acknowledged the scheme had flaws, specifically those rules that effectively set the guarantee available to lenders at a much lower rate than the headline 75%. “It’s actually less than advertised,” said Peter. However, as he pointed out, “If you are going to lend sensibly, you shouldn’t need a 75% guarantee.”

Other sources of finance

As a specialist in private equity/angel finance, Oliver Woolley stressed that businesses should look beyond debt funding in certain circumstances. “In fairness, for a lot of them [banks], it’s not appropriate to lend to a company where risk capital or equity capital is actually more suitable. And I don’t believe anyone thinks banks should be lending and replacing risk capital that should be replaced by equity,” he said.

KPMG’s David Brockhurst pointed out the advantages of Invoice and Asset Based Lending. “The way that you fund a business through invoice finance means that you focus on your cash receipts very carefully versus your invoicing,” he said.

As the morning session of the ThinkTank event drew to a close, participants were pointing to a certain disconnect between businesses and financiers, a disconnect that would have to be addressed in order to help create a sustainable recovery. In the following session, the panel looked at how such funding issues could be resolved.

SME Challenges

In the second ThinkTank session, the panel addressed discussed the challenges and facing SME businesses in the current trading environment.

When the ThinkTank panel reconvened for the first of two afternoon sessions, Allan Laing, Chief Executive of Pentagon Chemicals (Holdings) Ltd, stressed the positive side of running an SME business. “It’s challenging. It’s dynamic. It’s great fun,” he said. However, he was equally keen to address the concerns that he and other managers must confront.

Although each business faces its own set of challenges, Allan pinpointed “customer uncertainty”, specifically “second guessing what our biggest customers will want to do next”, as one of two major issues that affect Pentagon Chemicals.

The second major issue was cashflow management, in particular the credit terms stipulated by customers. “I think, generally speaking, the bigger the customer, the longer they want to take to pay,” said Allan. Cashflow management can’t be seen only in terms of the time lapse between raising an invoice and the customer making good on the payment. In the case of Pentagon Chemicals, raw materials are bought and imported long before the company fulfils its customers’ orders. “The cash-to-cash period can be as much as 180 days,” said Allan.

The recession has done little to improve credit terms. When questioned for Venture Finance’s own annual Credit Check survey, almost four fifths (78%) of accountants have seen debtor days increase by 14% or more in the last six months.

As Allan explained, long payment terms need not be a given, pointing out that as suppliers develop long-term relationships with customers they are often in a better position to negotiate improved terms. David Smy, a Senior Policy Adviser at the Department for Business, Innovation and Skills, also pointed out the need for SMEs to push for the best possible deal. “We think it’s very important that people can do that,” he said. “I think confidence is important, as is encouraging small businesses to go out and negotiate.” David sees late payment as an equally pressing problem. “From talking to small businesses, the problem that is heavier than, say, 90-day payment terms is a 60-day payment that doesn’t arrive on the sixtieth day,” he said.

“The growth agenda is the leading priority of the coalition government,” added David. “There’s a huge emphasis on trying to get the overall business environment right and the business environment for SMEs right. In terms of that overall business environment, I think we are making steps forward. We’ve committed to creating the most competitive corporation tax regime in the G20 on the tax side. And on the regulation side, we’ve got a policy where if we bring in new regulations then we want to pull out other regulations at the same time, so the overall cost of regulation decreases rather than increases.”

Accrued debts

While debtor/creditor and related cashflow management issues are seldom far from the minds of business owners and managers, the evolving recovery has produced its own set of challenges, not least the problem of accrued debts.

One of the surprising features of the 2008/9 recession was a lower than expected number of insolvencies, which many commentators have partly attributed to the leniency of creditors, including landlords, banks and HMRC.

Arguably, HMRC played a crucial role in helping businesses stay afloat, simply by making it known that they were prepared to accommodate cases where businesses were not in a position to pay their taxes on time (usually PAYE and VAT). Typically, when a payment came due, the taxman would defer and restructure the payment over a period of months.

In the short term, HMRC’s Time To Pay (TTP) scheme provided a lifeline for many SMEs during the recent economic storm. However, as Kate Sharp, CEO of the Asset Based Finance Association, pointed out, deferred payments of this nature potentially store up problems for the future. Indeed, mounting tax bills could reverse a trend of falling insolvencies (also noted by David Brockhurst, a senior manager in KPMG's Mid-Market Debt Advisory Group). "I think we are going to see a lot of businesses become insolvent because the taxman wants his money back," said Kate.

For those companies striving to turn their businesses around and take advantage of the expected recovery, the TTP hangover represents a potential double whammy. On the one hand, a mounting tax bill represents a drain on available cash. On the other, the prospect of a spike in insolvencies in the near future adds to the economic uncertainty discussed by the panel in the opening session.

Opportunities

The panel was keen to underline the positive factors at work in the economy, not least the opportunities afforded to exporters by a drop in the value of the pound. "With export-led businesses, the dollar and the euro have moved to benefit export-led businesses significantly," said Allan Laing. "Since the middle of 2008, when the euro was about 1.4, the dollar was about 2 to the pound and there were lots of exports coming out of Europe into the UK. That has flipped, and is now working to the benefit of UK companies."

As Oliver Woolley of the British Business Angels Association pointed out, many businesses that survived the recession are in a stronger position now than they were before the downturn. "Some of our clients are beginning to reap the benefits of competitors going out of business," he said. "That is helping them to grow their turnover. I think the point is they have really gained the confidence to continue investing in their business."

Smart Solutions

Towards the end of the ThinkTank session, the panel addressed the issue of providing finance that is not only reliable but also aligned with individual business needs

In the concluding debate, the discussion turned to SMEs' financing requirements. According to Venture's Credit Check survey, lack of working capital is currently affecting the ability of businesses to trade successfully. Thirty-two percent of accountants questioned in the survey said clients were turning away businesses because they lacked the working capital required to fulfil orders. Elsewhere, many SMEs are seeking funding to finance organic and acquisitive growth. Thus, matching finance provision with the requirements of SMEs was a key theme of the ThinkTank discussions, with participants stressing the need for funding streams that suit the unique circumstances of each business.

According to Kate Sharp, the time was right for financiers and businesses to take a long, hard look at the financial solutions on offer with a view to assessing their suitability for any given set of circumstances. "It is now time for us to get cleverer about the way we finance business, and it is time for businesspeople to get cleverer about the way they access finance," she said. "If more financiers and businesspeople had been wiser regarding what finance was appropriate to the needs of their business, I don't think we would be in quite the mess we are in now."

Kate argued that traditional credit lines often fail to meet the working capital requirements of growing companies. Where facilities such as overdrafts have to be renegotiated as a business grows, receivables finance is much more flexible since it is linked directly to the income generated by the business. Thus, the facility grows as the volume of business grows. Jamie Young, Director of Feist Hedgethorne, observed that renegotiating an existing funding line in the current financial climate could be a daunting prospect for many SMEs.

Jamie cited his own client-base as an example. "I have clients that have relatively modest bank overdrafts of £30-40k, and whose businesses are undergoing small amounts of growth," he said. "These clients have been concerned about approaching the bank for an increase in their overdraft facility in case that overdraft gets reduced."

The debate about "clever financial solutions" was more than a discussion of the relative merits of Invoice and Asset Based Lending versus more traditional forms of credit. At its heart was a widely shared perception that businesses should be aware of all the financial options on the table – asset finance, overdrafts, term loans, private equity, etc – and make a decision based on the right solution for the right circumstances.

Allan Laing argued that the industry itself must continue to evolve solutions that match the requirements of business clients. "What I see as a customer of bank lending and bank debt is that the offering to a company like ours is pretty inflexible and hasn't changed over seven years," he said. "Right now we have got 25-30% of our products in the company that we didn't have five years ago, and that is the nature of our business model. We have got to keep changing as we go along because some things drop off, new things come along."

Closing the gap

Perhaps the answer to providing businesses with appropriate funding lies in promoting a closer relationship between financiers and their clients. Certainly some of our ThinkTank panel expressed concern about the perceived gap between financiers and finance-seeking clients, the distance between the two making it difficult for financiers to make a proper assessment of an applicant's viability. "I think the remoteness of certain lending institutions is the challenge," said Oliver Woolley, who cited the workings of credit committees as a case in point. "I think there is a disconnect between the credit committee and the customer," he said. "You have the customer – a small business owner – who goes to see his or her bank manager and presents a case. The bank manager will normally say, 'This looks interesting. Yes, I'm sure we can get this through.' Then they put it up to a credit committee who has no connection with the business owner, and the committee then comes up with a decision based on various criteria, crediting scoring and formulas. The final decision conveyed by the bank manager is often, sadly, that the credit committee has declined the application."

As Venture Finance Managing Director Peter Ewen pointed out, in traditional finance this decision is normally based on fairly narrow criteria and often ignores important factors such as the quality of the management team. "If you disregard the bigger picture and don't take a more balanced approach, your decision-making process isn't considering things properly," he said. In Peter's view, this chain of decision-making has contributed to a sharp decline in SME confidence within the finance industry.

At your service

The closeness of the relationship between financiers and their clients was seen by some of the panel as a reliable indicator of the overall quality of service, particularly within the banking industry. David Brockhurst argued that one of the unintended consequences of the restructuring of the banking industry has been an erosion of the individual bank manager's authority and an increased disconnect from business customers. "The demise, if you will, of the local bank manager," as David puts it. "It drives out any individual's ability to be quite agile."

As Peter Ewen sees it, the competitive drive to cut prices ahead of the financial crisis also contributed to the problem. "By driving down costs, we have seen a production-line situation in some parts of the industry and that has affected service quality," he said. These factors beg the question of whether businesses themselves focus too much on price rather than service.

Evidence from Venture's Credit Check survey suggested a shift in priorities, with 60% of accountants stating that reliability rather than price was the key driver when businesses assessed the quality of their relationship with lenders. "I see that all the time in our client-base," said Peter. "Clients are beginning to say, 'actually a relationship is more important than the fee or the discount rate.'"

It's a finding supported by Jamie Young's experience with clients. While stressing that entrepreneurs certainly focused on both price and required guarantees, consistency was regarded as equally important. "The big thing is whether funding is going to be there going forward or if it's going to be pulled," said Jamie. "That's ultimately where a lot of my clients are at."

As businesses prepare to address the challenges of recovery, there remains a real demand not only for access to finance but also for a closer relationship between business owners and financiers. Assurances of reliability and consistency of service can also help restore business confidence that may have been lost during the recession. Equally important is the flexibility of finance packages, allowing SMEs to access funding that will fit their particular circumstances and therefore help them meet the recovery from a position of strength.

- ***The panel detected a shift in priorities, with many companies seeking a stronger working relationship with their financiers.***
- ***This has led to a switch in focus away from cost and towards value-added finance that is both reliable and aligned to business needs.***
- ***SMEs require funding that is sustainable, readily available and flexible enough to match the ambitions of the business.***
- ***The recovery of SMEs is presently held back by economic uncertainty and lack of access to finance.***
- ***Financiers should understand their customer needs and tailor their solutions accordingly.***

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