Client: Memset
Source: CA Magazine (Main)
Date: 01 January 2015
Page: 31
Reach: 17583
Size: 1457cm2
Value: 7620.11

LEND SUPPORT IN FUNDING FIGHT

WITH LENDING TO SMALL BUSINESSES ONCE MORE IN THE LIMELIGHT, RACHEL WILLCOX REPORTS ON WHAT'S BEING DONE TO BOOST SME FUNDING

AS THE Competition and Markets Authority (CMA) announced in November that it would launch an in-depth market investigation into small business banking, the thorny issue of lending to business is once again being thrust under the spotlight.

Although the British Bankers' Association said the industry would co-operate fully with any investigation, the major retail banks find themselves on the back foot.

Despite the economic recovery and government attempts to intervene, bank lending to SMEs remains tight. The Bank of England's Funding for Lending Scheme (FLS), launched in August 2012, recorded another poor performance in the second quarter (Q2) of 2014, with net lending by banks involved in the programme falling to minus £3.9bn between April and June, with a smaller quarterly drop of £128m in Q3.

However, beating up the banks for not lending may be oversimplifying the situation. State-backed Lloyds Banking Group, which bucked the industry-wide trend with positive net lending to SMEs of £384m between April and June, says that despite improved levels of business confidence there's still an (unfounded) assumption on the part of SMEs that banks aren't lending.

Meanwhile Ian Cowie, chairman of SME banking with RBS, told *The CA*: "Confidence is allowing people to make investment decisions based on future order books. But from an RBS perspective, the question is how do we rebuild that trust? We need to remove as many barriers as possible. Rather than wait for customers to come to us, we're on the front foot saying we know you, we could support you and lend to you."

The change of tack follows the publication in November 2013 of an independent lending review of RBS carried out by former Bank of England deputy governor Sir Andrew Large. It found the processes in place to make lending decisions were not user-friendly and warned of innate risk aversion among relationship managers and credit officers at the bank.

While Cowie maintains RBS's strategy is paying off with gross lending so far this year up 25-30 per cent on 2013 figures, others think it will take more than a few well-phrased letters to alter customer perceptions. Indeed, recent UK200 Group research found that 43 per cent of members think the banks are simply paying lip service to the idea of rebuilding trust. ICAS's own research suggests ongoing reluctance among high-growth SMEs to pursue the bank funding route.

Failure to come up with assets to secure the loan against, or to provide credible financial information and forecasting, will also scupper a loan bid.

Client: Memset
Source: CA Magazine (Main)
Date: 01 January 2015
Page: 31
Reach: 17583
Size: 1457cm2
Value: 7620.11

➔

"You'd be amazed how many don't have a decent business plan," says Adam Tavener, chairman of Clifton Asset Management. "Unfortunately, there's a mindset among some SMEs that banks somehow have a social responsibility to lend. But you have to make a case for yourself. The banks aren't there for risk capital. For businesses that are in turnaround or in rapid growth where the requirement for funding outstrips cashflow, the banks won't take a true risk."

At the same time Robert Pattullo, convener of the ICAS Business Policy Committee, says procedural changes at the banks mean that the relationship with your bank manager has in most cases been superseded by faceless credit committees and a "tick-box" approach to lending decisions, putting even more emphasis on the business plan and numbers. He says: "The old days of knowing your bank manager and his authority limit are over."

The tightness of traditional bank credit is an opportunity for new entrants across both debt and equity finance to come in and fill a void, says Phil Charles, head of enterprise at KPMG Scotland. "But it's more likely to be on a higher return or equity basis than on a pure bank facility basis."

The UK's alternative funding sector provided almost £2bn to SMEs in 2014 and the amount raised through alternative finance intermediaries, including crowdfunding, peer-to-peer lending and invoice trading, is predicted to reach £4.4bn in 2015, according to a study published by innovation foundation Nesta and the University of Cambridge, with support from PwC and ACCA.

With new provisions in the Small Business Enterprise and Employment Bill due to come into effect in the latter half of 2015 – which will see banks forced to refer the 250,000 small businesses they turn down each year for funding to non-bank funders – the expectation is that the market will continue its rapid rise.

Graham Blair, area director for SME Banking Scotland at the Bank of Scotland, says structuring finance over a different vehicle can be more cost effective than an overdraft: "It's about providing the right products at the right time and that's why we need to raise awareness of the lending schemes available."

Gareth Magee CA, partner at Scott-Moncrieff, comments: "Surprisingly, one of the major obstacles is a lack of knowledge of what's out there – or to put it another way, a lack of visibility of the options. There is funding, but in some cases it's very well hidden. Funders need to be far more communicative, and those seeking funding need to do a bit of legwork to find it. Business owners are being realistic, and they want to borrow. So, in 2015 it would be good to see the gap between those seeking funding and those offering funds getting considerably narrower."

"Surprisingly, one of the major obstacles is a lack of knowledge of what's out there – or to put it another way, a lack of visibility of the options. There is funding, but in some cases it's very well hidden"

Gareth Magee CA

A guide outlining the full range of debt and equity finance options for businesses from start-up to growth to listing on the stock exchange was published by the British Business Bank and the ICAEW in June 2014, backed by 19 leading business and finance organisations including the CBI, the FSB and the British Chambers of Commerce.

Finance Scotland [www.finance.scotland.gov.uk] also provides practical information and support on finance and funding for growth businesses.

"The market has changed considerably in terms of products with a wide variety of products to suit every different lending need," says Phil Orford MBE, chief executive of SME lobby group the Forum of Private Business (FPB). "However, many firms are reluctant to explore relatively new routes to finance, worried about the potential catches."

NOT A LEVEL PLAYING FIELD

The joint study by the Competition and Markets Authority and the Financial Conduct Authority earlier this year found:

- The supply of business current accounts (BCAs) remains concentrated – 85 per cent of BCAs in England and Wales are provided by the largest four providers, with Scotland and Northern Ireland even more so.
- The supply of business loans also remains concentrated – almost 90 per cent by volume are provided by the largest providers in each of England and Wales, Scotland and Northern Ireland.
- Almost 60 per cent of BCA customers at the four largest UK banks also have a personal current account with the same bank.
- Only one new BCA provider (Metro Bank) has entered the market in recent years.
- Initiatives on improving access to information on creditworthiness and new bank authorisation are likely to reduce some barriers to entry and expansion.
- Significant barriers to entry and expansion remain, partly thanks to customers' attachment to the bank's branch networks and payment systems, reducing pressure on the big banks to compete.
- The situation is made worse by low switching rates and customer inertia.

➔

Client: Memset
Source: CA Magazine (Main)
Date: 01 January 2015
Page: 31
Reach: 17583
Size: 1457cm2
Value: 7620.11

The equity funding market has also had a bumper year with 2014 marking the strongest year for UK fundraising since the financial crisis, according to data provider Preqin.

Crowdfunding success stories such as beer maker BrewDog may have captured the headlines, after it secured its £4.25m target for investment from its customers, but KPMG's Charles warns the model will never provide a large percentage of the growth funding market. In contrast, private equity interest in the SME market is growing.

While going down the PE route isn't an easy decision for business owners used to being in control, the benefits of PE investment should extend further than simply a cash injection, says Tom Faichnie, corporate finance partner with Campbell Dallas. He says: "Realistically they're investing in the management team and are there to provide guidance and assistance to them. It can help give more structure to the business, which will all add to the value if it's sold."

Tavener says market evolution will increasingly see SMEs selecting from a portfolio of different funding options depending on their specific requirements. The Internet environment is already making it much easier to identify schemes and do much of the groundwork yourself.

Tavener adds: "Ultimately, it should get easier for good businesses to get funding and the new environment will mean that even a relatively unsophisticated business owner will have access to a host of other funders."

Government initiatives intended to stimulate the market – for example, the Business Growth Fund, which provides development capital for a minority stake – continue apace.

"If you can impress them, you can get an investment of millions. They will appoint people to your board and they have some good knowledge and network connections but you have to hit the jackpot," warns ICAS member Ken Smith, commercial director at Cloud hosting provider Memset, who over the course of his career claims to have tried every conceivable funding option.

"Awareness of other Government initiatives such as the Export Credit Guarantee and Enterprise Finance Guarantee are so tied in with the banks that their success cannot be determined without looking at the wider lending landscape," says FPB's Orford. "The establishment of the British Business Bank is a welcome move to provide a central source for SMEs seeking funding, but it is too early to assess if this will be successful."

Despite a proliferation of grants available to business not everyone is convinced it's a good route to pursue, even though figures suggest 80 per cent of those businesses that apply for grant funding receive it. "The government is full of good intentions, but it's an incredibly bureaucratic process. My experience has been it's not worth the effort," Smith says.

Whichever route you opt for, the reality is that the decision-making process isn't a short one. "With the market as it is, it takes time to raise finance. Forecast ahead to work out what funding you will need and when, start the conversations earlier armed with quality business information," Charles urges.

The CMA investigation is expected to take 18 months to complete. In the meantime, accountants have a vital role to play in helping their SME clients navigate the choppy funding waters, put together compelling business plans and argue the case for funds. What's certain is that alternative finance's success has taken it squarely into the mainstream. The only question now is at what point people will cease to regard it as alternative. CA

RACHEL WILLCOX IS A FREELANCE BUSINESS JOURNALIST

"The new environment will mean that even a relatively unsophisticated business owner will have access to a host of other funders"

Adam Tavener

FUNDING GAP WARNING

The warning contained in the Breedon Report, published in March 2012, continues to ring all too true. The report, published by a Government-appointed committee led by Legal & General boss Tim Breedon, said that access to finance for businesses needs to be improved or there could be a funding gap of up to

£190 BILLION

by 2017.

Client: Memset
Source: CA Magazine (Main)
Date: 01 January 2015
Page: 31
Reach: 17583
Size: 1457cm2
Value: 7620.11

➔

BrewDog secured £4.25m investment through crowdfunding