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Follow-Up Research into Mid-Cap Businesses having difficulty raising Bank Finance

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The findings and interpretations in this report are those of the authors and do not necessarily represent the view of BIS.

Contents

EXECUTIVE SUMMARY 5

1. INTRODUCTION 9

2. BUSINESS CHARACTERISTICS 10

3. ACCESS TO FINANCE 12

3.1 Types of external finance sought over the last 3 years: 12

3.2 Assessment of relationship with their bank: 13

3.3 Regularity and extent of contact with the bank 13

3.4 Reasons for seeking bank finance in 2010. 14

3.5 Amount of finance sought 15

3.6 Terms sought and offered 15

3.7 Banks approached 16

3.8 Alternative Banking Sources 16

3.9 Views of the Application/Negotiation Process 17

3.10 Format of application and information required 18

3.11 How the bank's decision was communicated 20

4. REASONS FOR DIFFICULTIES 21

4.1 Nature of difficulties 21

4.2 Changes to banks' policies 22

4.3 Amount of finance applied for that was obtained 23

4.4 Reasons for rejection of the offer by the business 24

4.5 The banks explanation for its decision 24

4.6 Factors that contributed to the business having difficulties 26

4.7 Assistance with application 26

4.8 Length of time to get a decision 27

4.9 The Cost of the Banking Offer 28

4.10 Alternative Sources of Finance: 29

5. IMPACT OF REJECTION/DELAYS IN BANK FINANCE 29

6. RESOURCES AND STEPS TAKEN TO IMPROVE ABILITY TO OBTAIN EXTERNAL FINANCE 33

6.1 Internal Resource Experience 33

6.2 Types of external assistance used 33

6.3 Knowledge and Management of Credit Rating 34

7. FUTURE POLICY GUIDANCE 34

7.1 Views on need to improve access to finance 34

7.2 Views on role of government 35

8. CONCLUSIONS 37

REFERENCES 39

APPENDIX I: SUMMARY OF DIFFICULTIES IDENTIFIED BY EACH OF THE INTERVIEWED MID CAP BUSINESSES 40

EXECUTIVE SUMMARY

This report commissioned by the Department for Business Innovation and Skills (BIS) and carried out by the Centre for Enterprise and Economic Development Research (CEEDR), presents the findings from a follow-up, qualitative study of 15 mid cap businesses (defined as having a sales turnover of between £25m and £500m). These were drawn from the 2010 Finance Survey of Mid-cap Businesses undertaken by BDRC Continental to explore the issues in much greater detail. Of the businesses that agreed to a follow-up interview, 25 reported bank finance problems and a further three were identified as 'discouraged borrowers'.

The **objectives** of the extended telephone interviews with the finance directors in these 15 businesses were to:

- Explore reasons why businesses have been only partially successful or unsuccessful in raising finance, and whether the recent performance of the business could partly explain the problems the business was experiencing.
- Indicate what the impacts on the business of problematic, partial or unsuccessful applications have been.
- Examine the Finance Director's knowledge of different types of external finance and the extent to which these options have been considered and pursued.
- Examine the extent of the company's expertise in raising bank and alternative sources of external finance and the extent to which external advice and assistance has been sought and used in applications.
- Provide some future policy guidance from the surveyed businesses with regard to improving mid-cap access to bank finance and other suitable alternative sources of external finance.

It is important to note that the findings from businesses within this part of the research will not be representative of mid-cap businesses in general who are generally able to obtain the finance they need[1]. This research explores the difficulties the businesses experienced raising finance in greater detail than the main survey.

Main Findings

In terms of their **business characteristics**, the 15 mid cap businesses interviewed as part of this research project were drawn from across the English regions and Northern Ireland and covered a wide range of sectors. They were all long established businesses, and although ten claimed to be in profit in 2009-10, they were all affected by the recession with none having experienced an increase in profit over the last three years.

Most of the businesses that reported difficulties in raising finance could obtain at least some finance, and in some cases the businesses turned down the finance because the terms and conditions were in its opinion unsatisfactory:

[1] See 2010 Finance Survey of Mid-cap Businesses

- Over the last three years, nearly all the mid cap businesses had approached the banks for overdraft and/or loan finance or invoice finance and with just three exceptions, had succeeded in obtaining all or some of the finance sought.
- During 2010, just four of the businesses obtained all the finance they were seeking, four received less than they were looking for, and another three were waiting for a final offer at the time of interview. Of the remainder, one experienced outright rejection, two were forced to reduce their debt exposure, and one was discouraged from applying for finance.

Despite most obtaining finance eventually, all of the businesses reported experiencing difficulties obtaining the finance. From the business perspective, the nature of the difficulties included:

- Maintaining existing levels of debt finance as their banks sought to reduce the level of debt exposure or refused the business's request to increase overdraft limits.
- Problems in maintaining debt finance at what the Finance Director considered to be at a reasonable cost. In particular, two-thirds of FDs were unhappy about the cost of bank finance offered, the main source of complaints relating to set up and maintenance charges. That said, most respondents accepted that they had to pay market rates of interest.
- Banks wanting to shift the balance away from less expensive overdraft finance towards more expensive invoice finance.
- The revised terms being more stringent than the firms expected, based on their previous experience raising finance.

Finance applications are not distinct events and are a continuation of an ongoing process:

- Almost all of the 15 cases were seeking a continuation of existing financial arrangements in order to provide working capital.
- In a number of cases this also involved negotiations about ways of re-financing the business.
- All the businesses approached their existing bank first and just over half considered applying to more than one bank, finding the process with another bank to be harder due to a lack of any previous relationship.
- Although the main mid-cap survey found it took 1.6 months on average for a loan application to be approved, in seven cases surveyed here it took up to three months to receive a decision, whereas in the other eight it took at least four months usually because FDs wanted to negotiate a better deal.

The application process for obtaining finance is now more demanding than businesses previous experience:

- Although all 15 businesses had experienced financial directors in place with considerable experience of accessing various forms of bank debt finance (13 businesses had FDs that were fully qualified chartered or certified accountants), they all found the process for raising finance more difficult than previously.
- Several FDs were not prepared for the level of toughness taken by the banks in the negotiations. A frequent criticism was that the application process took much longer and was more demanding than previously.
- All but one of the businesses referred to using external assistance (mainly accountants, auditors, and solicitors) to support their applications for bank finance.
- Two-thirds of the businesses had also taken steps to manage and improve their credit rating.
- However, businesses were less experienced in sourcing other types of finance, for instance mezzanine finance.

Although there appears to be obvious reasons why some businesses had difficulties obtaining finance, for other businesses it was not immediately clear why they should experience difficulties:

- Although all the businesses were affected by the recession, which led to declining turnover, it is clear that the interviewed businesses fall into three distinct performance groups: (i) those that are successful – where the business is comfortably in net profit and sales turnover performance is holding up or increasing; (ii) those with moderate performance where the business is in net profit, but sales turnover has been erratic: and (iii) those whose performance is poor – where the business has been loss making or at breakeven and sales performance has been static or erratic.
- All five of the successful businesses were able to obtain finance in 2010, albeit after a period of negotiation over terms and bank charges, or in two cases using other sources. However, the difficulties these businesses experienced in the process of obtaining the finance negatively impacted on sales turnover (in two cases) and profits as a result of the increased cost of finance (in three cases). All five of the moderately performing businesses also managed to obtain at least some finance in 2010, although less than they were originally seeking in three cases, whereas the other two cases eventually obtained all that they required by going to another bank. The difficulties experienced by these businesses were considered by four of them to have constrained their growth and development. The five businesses in the poorly performing group were the least likely to obtain bank finance, being refused finance or experiencing a significant reduction in the amount of lending that their bank was prepared to offer.
- As to the **reasons for the difficulties,** nine of the businesses attributed them to changes in the bank's policies whilst a further two thought this was partly the case. Nine of the FDs said that they did not accept the bank's explanation, three said they partially agreed, whilst another three said they understood the bank's position.

- Businesses reported that the banks themselves often justified their decision to the firm in terms of changes in central bank policy as well as in terms of the business not performing well enough.

A lack of access to finance was impacting on business performance:

- Just four businesses considered that they have been able to go ahead unaffected. Of the eleven who were affected by the difficulties in raising finance:

  - six went ahead but on a smaller scale.
  - three took longer to go ahead but at the planned scale.
  - two took longer to go ahead and on a smaller scale.

- More than half (8) of the FDs considered that their difficulties with the bank were having a negative impact on sales turnover and all but two of the FDs considered that their difficulties with the bank were having a negative impact on profitability. However, just four businesses stated that the difficulties with the bank had led to reduced employment.

Businesses expressed a number of concerns:

- Businesses communicated an overall desire for bank policy to be more attuned to the needs of businesses, with several FDs feeling that modern banking culture has become divorced from a desire to service business needs.
- There was also concern that banks take a short term view of the performance of the business and there is a need for banks to take a longer term view of the financing needs of businesses.
- Businesses also consider a need to reform the banking system in order to encourage more competition between banks.

1. INTRODUCTION

This is a report of the findings from the 15 extended telephone interviews that have been conducted with a sample of the mid-cap businesses that were identified as experiencing difficulties accessing bank finance in the 2010 finance survey of mid-cap businesses undertaken by BDRC Continental Research. BDRC undertook a telephone survey of 401 mid-caps, businesses defined as having sales turnover of between £25m and £500m. The BDRC survey repeated the 2009 finance survey of mid-cap businesses, further exploring how the current national economic climate and 'credit crunch' is impacting on bank finance to mid-cap sized businesses in 2010. There is evidence that recent economic trends have led to bank lending to businesses being tightened, with banks having stricter credit controls and requiring increased security, leading to increased difficulties associated with raising commercial finance. This is combined with the perceived relatively high margins charged at a time when Bank of England interest rates are at their lowest ever rate, which is seen to be preventing business development and growth (Fraser 2010, Packham et al. 2008, FSB 2008 and various recent quarterly reports).

The mid-cap market represents approximately 10,000 UK businesses, which are established, major employers (51 per cent in the BIS 2010 survey had more than 250 staff) that can make a vital contribution to the UK's economic recovery. These larger businesses, with established bank lending and credit records are therefore an important barometer of the state of the bank lending and external finance markets in the UK. It is envisaged that any improvements in the availability of finance will reach these businesses sooner due to their relative lower risk compared to SMEs.

Whilst the BDRC survey assessed the demand for bank finance amongst mid-caps in 2010, and found the majority of businesses obtained finance in 2010, it also revealed incidence of some businesses experiencing problems accessing bank finance. In addition, there were isolated cases of businesses being 'discouraged borrowers' that did not actively pursue bank finance, despite having external finance requirements. The main aims of this follow-up, in-depth, qualitative survey, were to examine these problem cases and to:

- Outline what the main reasons (e.g. working capital, project investment, acquisition) for seeking bank finance are and how much finance was sought.
- Explain why businesses have been only partially successful, or unsuccessful. Exploring whether the reasons related to prohibitive costs and requirements of borrowing, or the failure of the business proposal.
- Provide evidence of the cost and security requirements relating to bank finance and how this compared with prior perceptions.
- Indicate what the impacts of problematic, partial or unsuccessful applications have been.
- Examine the extent of knowledge of different types of external finance and the extent to which these options have been considered and pursued.
- Examine the extent of the company's expertise in raising bank and alternative external finance and the extent to which external advice and assistance has been sought and used in applications.

- Provide some future policy guidance from the surveyed businesses with regard to improving mid-cap access to bank finance and other suitable alternative sources of external finance.

It is important to note that the findings from businesses within this part of the research will not be representative of mid-cap businesses in general, but rather those businesses that are experiencing problems.

The BDRC survey indicated that 26 per cent of mid caps (104 cases) sought bank finance in 2010 with 8 per cent (24 cases) experiencing problems in accessing loans and 5 per cent (20 cases) experiencing problems in accessing overdraft finance[2]. The survey identified 25 businesses that reported problems raising bank finance and a further three that were identified as 'discouraged borrowers' that also indicated that they would permit a follow-up interview to take place. CEEDR interviewed 16 of these businesses, although one was excluded from this analysis as the interview revealed that the company had in fact received considerable support from its bank rather than experiencing difficulties. The findings presented here therefore relate to the 15 relevant cases interviewed.

All but one of the interviews were conducted with the company's finance director (the exception being a managing director). The interviews typically took between 30 and 45 minutes to complete.

After summarising the characteristics of the interviewed businesses, we will focus on a number of key questions relating to their recent experiences of dealing with the banks, illustrating each finding with reference to two or three of the cases. A summary of the difficulties experienced by each of the 15 case studies can be found in Appendix I.

2. BUSINESS CHARACTERISTICS

The 15 cases were drawn from across the nine English regions (with the exception of the North East) and Northern Ireland. Three were located in the South East and two each in the East of England, East Midlands, London and North West, with one in each of the other regions.

They covered a **wide range of sectors**, including steel manufacture, engineering, port operation, vehicle distribution and retail, clothing distribution and leisure and travel. It is worth noting that four were related to the property and construction sector, including a property company, a construction company (specialising in student accommodation), a manufacturer of plastic mouldings for the construction sector, and a building R&D organisation.

They were all **long established businesses**. All but two had been trading for at least 20 years and six of them had been in existence for more than 50 years (three of which were

[2] Reported percentage figures are weighted.

founded more than 100 years ago). Eleven businesses are private limited companies, three are public limited companies and one is a registered charity. Five of the businesses referred to still being family owned, whilst five were subsidiaries of other UK (2) or overseas (3) companies and one was 50 per cent owned by a US company. Three had experienced a change of ownership in the last five years, including a management buyout and a flotation on AIM.

The 15 companies covered a **broad size range** within the ‘mid-cap’ definition. With respect to their employment, the smallest (a commodity broker) had just 14 employees and the largest (a construction R & D company) 650 employees (note: a steel company with 350 employees was part of a larger group with circa 5,000 employees). Six of them had between 100 to 199 employees. Twelve had experienced a decrease in employment since 2007 compared to just three that had increased their employment. Overall, the employment in these 15 businesses fell by 15 per cent between 2007 and 2010.

In terms of their sales turnover, their average (mean) size in 2009-10 was £57m, with a range from £16m to £145m (a construction company). This compares with a mean value of £63m in 2006-7 and £56m in 2008-9. Eight businesses experienced a decline in sales turnover between 2008-9 and 2009-10 compared to six experiencing an increase (the other two remaining stable).

With regards to their **net profitability** in 2009-10, eleven of the 15 interviewed businesses claimed to be in profit with another two saying that they had broken even whereas two had made a loss. When asked about the profit trend over the last three years, none had experienced an increase, although five had within the last year. Five had faced a downward trend and another five described the trend as erratic (with at least one year in profit). Another five said that their profitability had been stable or held up well over the three year period.

The businesses were generally positive in their forecasts for performance over the current financial year to 2011, with seven forecasting increased sales turnover and improved net profitability (two indicated a reduction in net losses) and four forecasting increased employment (manufacture, vehicle distribution (2) and transport). Conversely, four businesses forecast declining sales turnover (broker, distribution, travel and property sectors), one business forecast poorer profitability (broker) and one forecasting reduced employment (construction R&D).

3. ACCESS TO FINANCE

3.1 Types of external finance sought over the last 3 years:

As Table 1 shows, nearly all these mid-cap businesses had considered and approached the banks for overdraft and/or loan finance over the last three years and with just two exceptions in the case of overdraft finance and one in the case of loan finance, had received a positive outcome. The six businesses applying for invoice finance had also been successful (in some of these cases the bank suggested this type of finance rather than overdraft finance). Very few of the businesses had considered and applied for other forms of finance. The 'other' category includes letters of credit and a revolving credit facility.

Although it would appear that more than 90 per cent of the applications for finance by these mid-cap businesses led eventually to a successful outcome in the sense that some if not all of the external finance sought was obtained, the outcome was far from satisfactory from the business's perspective because of a number of difficulties that they experienced, as will be discussed below.

Table 1: Access to Finance

What sources of external funding did you: (a) Consider? (b) Approach over the last 3 years? (c) What was the outcome?	Consider	Approach	Outcome	
			Yes	No
Bank overdraft	12	12	10	2
Bank loan	13	13	12	1
Invoice Finance	6	6	6	
Asset Finance				
Mezzanine finance	1	1	1	
Private equity fund	1	1	1	
Public equity				
Loans / equity from family or friends				
Leasing or hire purchase	2	2	2	
Public sector grant / award	1	1	1	
Supplier/Buyer - Partner Company finance				
Corporate bonds				
Other (please specify)	4	4	4	

3.2 Assessment of relationship with their bank:

Satisfied with Relationship:	8
Dissatisfied with Relationship:	6
Unclear:	1

Just over half of the interviewed finance directors were broadly satisfied with their relationship with their bank(s). Typically, these relationships had been built up over many years and in some cases they had developed a personal relationship with an individual bank manager lasting ten or more years. Where the interviewed business managers expressed some dissatisfaction this reflected: (i) a change from having a relationship manager who had a good understanding of the business to having a local manager with a poor understanding and less decision-taking responsibility; (ii) the view that having a good relationship with their local relationship or account manager counted for little as decisions tended to be centralised; and (iii) the perception that relationships had become more strained because of the bank's stricter lending policy, with individual bank managers having less opportunity to use their discretion than previously.

3.3 Regularity and extent of contact with the bank

Occasionally with annual face to face review	7
Quarterly review meetings	2
Monthly telephone reviews	4
Weekly telephone discussions	2

Almost half of the businesses only have occasional contact with their banks, their main form of contact being an annual face to face review meeting with their RM. This included a discouraged borrower travel agent whose only meetings with the bank were at year end to discuss their audited accounts. Two businesses referred to quarterly review meetings with their RM, with a further four businesses stating that they have regular monthly reviews, typically undertaken by telephone, but accompanied by emails with account management results. Two businesses, an importer and a manufacturer, were in weekly telephone contact with their RMs. A construction business, operating with quarterly financial review meetings between their bank Relationship Team and Senior Board members, also had a non exec director from the bank on their board - *"which is helpful in giving insight to the operation of the business and its progress."*

Case 2:
The business had more than 10 years relationship with previous RM, who understood them, but got promoted and was replaced by a paper-pusher. "The new breed of RMs are like postmen. They don't have the same level of skill and decision making power of their predecessors. They are simply form fillers who defer to central decision makers."

Case 6:
We banked with the Bank for 20 years – reasonable relationship with bank, but not prepared to offer them any overdraft finance. They have a decent enough Account Manager, but that person is not a decision maker.

Case 14:
Have had a long standing relationship with the bank, but relations with previous RM got a bit strained towards the end of their time – now improving with new RM.

3.4 Reasons for seeking bank finance in 2010.

(a) Working capital: 14

(b) Asset purchases: 1

(c) R & D: 1

(d) Acquisition: 1

(e) Management buy out: 1

(f) Refinancing: 9

Almost all of the 15 cases were seeking a continuation of existing financial arrangements with their banks in order to help finance the day to day operation of the business. In a number of cases this involved negotiations with banks about ways of re-financing the business. Sometimes this was initiated by the business themselves as for example when the business need to raise additional finance for a particular contract or where they wanted to reduce term loans whilst increasing their overdraft facility, but in other cases it was the bank that wanted to change the debt financing structure in order to reduce its exposure.

Case 1:
The business requires bank debt finance in order to service clients and purchase stock. Effectively, the bank has been seeking to refinance the business on more favourable terms for the bank, by reducing the level of debt and increasing the cost of the debt.

Case 10:
Fundamentally, the business had refinancing requirements as loans are operational on three year terms and required new arrangements to cover cash-flow/working capital requirements of the business.

Case 14:
In 2009/10 the business was looking for an extension to the £4m credit line in order to assist with the acquisition of a business and facilitate the additional stock purchase required to operate the extra business effectively.

3.5 Amount of finance sought

Half of the cases were seeking to maintain their existing level of debt facilities with the bank, with possibly some re-balancing between overdraft and loan finance, whilst the other half were seeking additional finance, in several cases to help fund particular projects (notably in the construction sector) or an acquisition. The average amount sought was £24m (median £10m), with six cases seeking up to £5m of debt funding and at the other extreme three cases looking for more than £50m.

Case 5:
Undertook annual bank facility review in May 2010 – wanted to at least maintain current level of £10m finance – although this was not always sufficient.

Case 8:
Started process in September 2008, by seeking to refinance loans and in August 2009 to obtain additional £20m – increasing bank loan debt to £80m.

Case 15:
Seeking two £20m short term loans (i.e. £40m) to fund 2 construction projects in 2010 – needed to cover 85% of project cost (the other 15% being funded from internal sources).

3.6 Terms sought and offered

The terms were generally more stringent than what the firms were hoping for and expected based on their previous experience of raising finance before the credit crunch. For some it was that the banks wanted shorter repayment periods (sometimes as much as half the time sought e.g. a commercial vehicle distributor sought 7-10 years but was only offered 3-5 years); several complained about high set up fees and maintenance fees compared with

previous experience (set up fees typically increased from 0.5 per cent to 1.5 per cent and maintenance fees ranged from £25,000 to £125,000), a property developer complained specifically about the increasing cost of back-end fees; most were resigned to the levels of interest set, although one of the construction companies complained that bank margins had increased 2.5 times over previous arrangements (from around 2.5 per cent to at least 6 per cent above base).

3.7 Banks approached

When the 15 interviewed FDs were asked which banks they approached first, unsurprisingly, all the businesses approached their existing bank first as they considered that their existing relationship and previous track record with the bank would increase their likelihood of success. Two businesses (a property developer and a port operator) said that they used a banking syndicate comprising several banks.

Case 1:
Only used own bank as not looking to jump ship and thinks it sends a negative message that company is struggling.

Case 3:
Only approached own bank as had long standing account manager relationship and bank know their business & particularly since had bad year in 2008.

Case 7:
Initially, because good relationship with bank and they initially agreed to proposed changes in finance by email very quickly in summer 2008.

Case 15:
Only approached main bank as have long track record of obtaining short term loans from this bank and initially the bank seemed very favourable towards them.

3.8 Alternative Banking Sources

Just over half of the businesses surveyed had considered using more than one bank (8 of 15 seeking bank finance – including one discouraged borrower). Some already dealt with more than one bank so that it made sense to make enquiries to all of them, not just their lead bank. Others only seriously considered other banks once the negotiations with their existing bank became difficult. However, in a number of cases they did not proceed beyond an initial enquiry because other banks were not interested/did not understand the sector/business activity. For example, when their account manager moved to a rival bank, a business enquired about obtaining funding but was told that the bank would not be able to help. Indeed, those that only contacted one bank typically noted that this was because their bank understood their business, which was *“niche, complex, or potentially risky.”*

Experiences of seeking finance from other banks were mixed, with one business successfully obtaining the full amount they required at reasonable pre recession rates, whilst another business experienced a highly complex technical, slow and in their opinion tortuous due diligence process which was ultimately unsuccessful. A business seeking a 15 year mortgage over commercial property approached four banks, including their existing bank, and found that all four offered reasonable terms and conditions and chose the bank that offered the best finance package at the lowest cost.

There were a couple of cases, particularly for property development businesses, where several banks were regularly used for loans and one case where a complex banking club of four banks was in place.

Case 4:
"Although considered 4 other banks to see what the market had to offer, not really aware that any better offer could be made – the banks did not appear to be open for business!"

Case 5:
Consider other banks all the time, although there are not many to choose from. The problem is that the – although they show initial interest - business cannot supply accurate cash-flow forecasts, it is very fluctuating and the bank has to know and understand the business sector – so unlikely to find another bank to support them. Their main bank works very closely with the business and is regularly monitoring their performance – but new banks would require even more close scrutiny, which in itself would be problematic and inconvenient.

Case 10:
Tentatively made enquiries to other banks, but when considered the complexity of the refinancing in question it wasn't worth pursuing – too much to start again with another bank.

Case 14:
After knock back from their main bank when requested increase of £2m in 2009, after refusal from central credit committee after 2 months, they went to another bank, because the other bank had been in contact with them looking to get their business.

3.9 Views of the Application/Negotiation Process

The views of the interviewed FDs were typically influenced by their actual experiences in their dealings with the banks in 2009-10 compared with what their previous experiences had been, even as recently as 2007-08. Problems arose as firms were not expecting the banks to want to change the terms and conditions on existing finance arrangements (which had been made in pre-recessionary conditions). One business found that their bank wanted repayment of a loan which would necessitate the sale of assets; in other instances the bank wanted to restructure existing arranged debt finance, shifting from overdraft finance to invoice financing (which firms regarded as a more costly option). A number of FDs

commented that they were not prepared for the level of toughness taken by the banks in the negotiations and the additional charges that the banks wanted to impose on them. Several businesses had been trying to renegotiate terms over several months with the matter still being unresolved at the time of interview. A frequent criticism made by the FDs was that the application process took much longer and was more demanding than had been the case previously. And where an application was made to a different bank, criticisms were invariably made about in their opinion the excessive amount of due diligence that was involved.

Case 1:
Informed by letter from the bank of new terms of credit. This came as a shock as they already had finance in place and didn't expect the bank to change terms and conditions – so required additional work than expected. The process was most unwelcome and caused many sleepless nights of worry. The process has been dragged out over a long period of time, over 7 months and is still not resolved.

Case 4:
Have not previously experienced the level toughness from the bank and the time to negotiate terms of the loan. Everything is referred to central decision making units. The process took 3 months instead of 6 weeks expected, going back and forth to central committee. Feels that the business proposition was sound and that the bank was asking for far too much in fees.

Case 11:
The initial dealings and arrangements for the leveraged buyout preceded the recession and the banks were very keen to do business and very accommodating at the time – they offered a reasonable deal, reasonably quickly. An essential point is that the finance structure and covenants were set up prior to the recession and did not provide for sufficient tolerance for when the recession struck a year later.

3.10 Format of application and information required

The main format of applications was via formal interview, typically initially with RMs. In two cases it was suggested that an initial meeting with the RM led to a paper application, whilst one business applied online. For five of the cases the bank problems arising in 2010 were part of ongoing financial negotiations, for example one business referred to receiving a letter from the bank which introduced new terms of business that they were unhappy with.

Online	1
Paper	3
Interview	8

Information required for applications:

Accounts	12
Order Book/Pre-sale agreement	7
Cashflow projections	12
Security/Guarantees	11
Market Report	1
Business Plan	11
Venture Capitalist guarantee	1

Almost all of the 14 businesses that were seeking new finance or refinancing (excluding one discouraged borrower) were required to provide fully audited accounts, financial cash-flow projections, security information and guarantees and full business plan details. Additionally, seven businesses were required to provide evidence from order books, particularly in relation to invoice finance applications and also in one case for a developer where a pre-sale agreement was required. One business was required to provide a market report, whilst another was required to provide a guarantee from a VC investor.

Whilst the majority of FDs noted that the application requirements were as they had expected, most businesses (10) were comparing these requirements with similar banking requirements undertaken during the previous two years. Five businesses indicated that the application requirements were more detailed and complex than expected, with two comparing their experience in 2010 with similar banking requirements from 2007. In these cases there was a higher level of due diligence, sales and market reporting, security and guarantees and also a longer process than was expected and this was most notable where new banks were approached. One import business referred to the "*excessively heavy handed approach to due diligence"* of a new bank that was approached.

All of the businesses, with the exception of one that applied online, met with their RM during the application process and eight had meetings with senior corporate banking staff. There were mixed opinions as to how the banks had handled the expectations of the applicants, with six applicants indicating that the bank had warned them about the more stringent application process and increased fees, whilst five applicants mentioned that they had high expectations of success and two felt that it was unclear.

Case 15:
It was a longer and more arduous application process than ever experienced before. Also we expected to be fully successful, given our previous track record and the solidity of the market we are operating in, so it was a considerable shock and disappointment when we

only received half of the finance we required. At this stage, after 3 months, it was too late to go to another bank.

3.11 How the bank's decision was communicated

In the majority of cases the bank's lending decision was delivered to the applicant by letter, but in four cases this operated in tandem with a telephone call from the RM. In five cases the decision was delivered in a face to face meeting with the RM and one of these pertains to the discouraged borrower who was informed that lack of security would render any overdraft application unsuccessful. The email decision was in response to a query over covenants impacting on potential refinancing and formed the start of an ongoing negotiation process.

Letter	8
Meeting with RM	5
Telephone call from RM	5
Email	1

Twelve businesses followed up the bank's initial decision by entering into negotiation. Those that did not, looked to alternative finance, or in the case of the discouraged borrower did not seek external finance at all. Whilst some of the businesses that have negotiated with the banks have been successful in reducing fees or accessing more finance, for the majority it has been a tough, lengthy and largely unrewarding process.

Case 2:
We tried to negotiate with the bank and when we took on a major franchise in May 2010, it was evident that business forecasts were improving and we would require more working capital for increased stock levels. Information was presented to the bank at a meeting with a new RM. They were not impressed and it has taken a further 5 months of painful negotiations to achieve reinstatement of the full £1m overdraft facility required and the invoice discounting has still not been put back to 85%.

Case 4:
Over 3 months we negotiated to reduce the set–up fee and ensure that securities were not increased. We accepted the proposed interest rate increased of 2%.

Case 7:
Argued that the previous finance had been agreed by email, but the bank disagreed and said they would bring in the Head Office corporate restructuring team to investigate …. to impose the banks position. We brought in consultants to prove our financial viability for the level of finance required and were told all was fine, but the bank did not change and put charges up anyway. At this stage, after three months of negotiation, we decided to present ourselves to other banks.

4. REASONS FOR DIFFICULTIES

4.1 Nature of difficulties

Maintaining debt finance at reasonable cost (banks changing terms & conditions):	5
Maintaining level of debt finance required:	6
Shift from overhead to invoice financing:	3
Bank won't consider application because of lack of security:	1
Required repayment of loan within 3 months:	1
Security requirements too steep:	1
Covenants not sufficiently flexible for recessionary conditions:	1
Legality of covenants relating to letters of credit:	1

Most of the difficulties concentrated upon two related issues. First, six of the interviewed FDs identified the difficulties of maintaining existing levels of debt finance as their banks sought to reduce the level of debt exposure from what had been agreed previously, or refused the business's request to increase overdraft limits. Second, five FDs identified the problem as one of maintaining debt finance at reasonable cost. Much of the criticism and dissatisfaction of these businesses centred on their banks wanting to restructure the debt finance, shifting the balance away from overdraft finance towards invoice finance, but at a higher level of charges. Several FDs complained that their bank had introduced new terms and conditions at the annual review in 2010 which were more stringent and expensive than what had been agreed previously, sometimes only six months or so beforehand.

Other difficulties tended to be specific to particular cases. For example, a construction company that applied for two short loans to fund a new project complained about the long-time taken by the bank to arrive at the decision to grant just one of the loans. Another construction related company, legally constituted as a registered charity, experienced technical problems over the legality of the covenants applying to its letter of credit because, according to the interviewed FD, the seeming inability of the bank to understand how a charitable business operates and to come up with an acceptable solution.

Case 7:
The problems with the bank occurred 6 months later at the annual review in February 2009. At this stage they were informed that the bank was changing its policy towards overdrafts and could no longer sustain providing the business with £2.5m overdraft facility. "50 years of banking went out the door, as they refused to accept that they had agreed terms by email, claiming this was not legally acceptable. They then sought to

enforce draconian terms which were totally unacceptable."

Case 11:
Borrowings were permitted at pre recession levels and covenants did not have sufficient tolerance or ability to be flexed enough to allow the business to operate in recessionary times. They succeeded for 18 months, but it was clear that the banks were becoming agitated at the level of debt exposure and were looking to reduce this as soon as possible. Eventually one customer failed to meet a payment in time – even though the business saw this coming and entered into negotiations with the banks in November 2009 to pre-empt any problems, the payment was not made in time, the business failed to make a repayment on time and a covenant was broken. The banks then seized on this opportunity to impose new terms and conditions which eventually proved unworkable and forced a trade sale.

Case 12:
Difficulties have arisen subsequently because the bank now realises that it has offered them finance at a cheap rate and their internal policy is to increase their margins and profitability on lending. As such they have tried to change the terms and conditions of lending without renegotiating – most notably by reducing invoice discounting cap to £3.5m, increasing maintenance charges from £25k to £35k and trying to impose an additional 'low user charge'. They also allowed adjustment of mortgage (because the bank wanted to reduce amount of loan) and this also allowed the bank to increase the interest rate on the remainder.

Case 15:
The main difficulty experienced was the delay in getting a decision (3 months instead of 6 weeks) and then the last minute decision to only fund one of the projects, resulting in a shortfall of £20m project finance and no time left to entertain seeking finance from another bank.

4.2 Changes to banks' policies

Yes:	9
Partly (also result of firm's difficulties):	2
Not directly:	1

Nine of the businesses thought that the difficulties had arisen because of changes in the banks policies whilst a further two thought this was partly the case, with the firm's worsening performance also being a reason for the bank wanting to change the financing arrangements. In fact the banks usually justified their actions by explaining to their borrowers that there had been a change in their policy as a result of the measures introduced to the Basle II framework as a result of the financial crisis. This necessitated reducing their level of debt exposure across the board which would mean increasing their use of asset and invoice based financing methods instead of overdraft financing.

Case 2:
The bank decided to reduce its exposure to business debt and therefore cut the overdraft facility in half to £0.5m and reduced invoice financing from 85% to 80% of order book value (a reduction of £100k on order value).

Case 12:
Yes, the business feels that they entered into contractual arrangements which set out fee structures, interest rates and lending caps – for between 5 and 15 years. The bank has tried to alter these, because of changes in market conditions.

Case 14:
The decision in 2008 to remove overdraft and replace with increased level of invoice finance credit was due to the Basle business banking restrictions on lending. Subsequently the decision that the business was too risky to increase the invoice discount finance facility by a further £2m was also due to these bank restrictions. In the opinion of the FD, the business was not too risky – as it has subsequently proven.

4.3 Amount of finance applied for that was obtained

At the time of interview, just four of the businesses had managed to obtain all the finance they were seeking from the bank and a further four received less than they were looking for. Another three cases were still negotiating with their bank and waiting for a final offer at the time of interview. Of the remainder, one experienced outright rejection, two were forced to reduce their debt exposure, and one was discouraged from applying for finance.

Case 2:
Bank lending was effectively reduced by £600k overnight.

Case 7:
They cut the offer of finance in half to a total of £1.4m, with overdraft capped at £1m and the remainder to be mezzanine finance term loan of £400k over 5 years.

Case 12:
Initially received all finance required, but had invoice financing cap reduced by £0.5m. Also reduced mortgage level down from £6.5m.

4.4 Reasons for rejection of the offer by the business

Too expensive:	7
Too much security required:	2
Structure of invoice finance:	1
Terms and covenants which allowed bank to take control of business:	1
Restrictions over cross subsidy:	1

Nine of the businesses rejected the banks offer, at least initially, and in several cases negotiations were still taking place at the time of interview. The main reason for rejection was that the terms were considered too stringent and the charges too expensive, whilst others rejected the offer because too much security was required, the structure of finance was considered inappropriate and expensive, or the terms and covenants would give the bank too much control over the business in the event of the company experiencing any difficulties in repayment.

4.5 The banks explanation for its decision

Business not performing well enough:	5
Terms been too generous previously (discounted lending previously):	2
Changes in bank policy (following Basle II):	6
Charges need to reflect level of risk in the business:	1
Not a secure risk:	2
Bank had to reduce exposure to low cost overdraft finance:	2
Further loan would mean over exposure to debt finance	1
Failure of company to comply with covenant due to late payment:	1
Offer reflected current market rates:	1

When the interviewed FDs were asked what reasons if any the bank gave for rejecting the application, offering less than they wanted, or asking for more stringent terms and security than expected, six of them said that the justification related to changes in bank policy as a result of market conditions and the measures taken to strengthen the Basle II agreement. Others were told that the low cost lending that the business had benefited from previously could no longer continue given the changed market conditions and that the bank had to

reduce its exposure to low cost overdraft finance. Five FDs reported that the bank had told them that their business was not performing well enough. These were all businesses that had experienced falling sales turnover and had made a loss in at least one year since 2007. Falling asset values were also an issue for one company, as was a poor credit score in another.

Whilst most (9) of the FDs said that they did not accept the bank's explanation, three said that they did agree partially whilst a further three said that they understood the bank's position. Several felt that the bank had overestimated the risks involved in the business, for example citing a number of considerations in their defence including: the amount of property security that the business could offer; their orders from blue chip companies; an underlying positive cash flow; very low level of customer defaults; and their previous good repayment track record.

Case 9:
Only partially – the business was performing poorly, but still retained a considerable property asset base, which would be of greater value in the future, had they been able to hold on to this, but the bank has forced them to sell off assets to make early repayment of loans and consequently the business has declined.

Case 11:
No – although they acted within their powers, it was a totally unreasonable over reaction to one failure, acting under covenant structures that took no account for the recessionary times in which it took place. There should have been more flexibility to deal with this. They feel that the banks abused their position and it is inexplicable to them as to why they panicked. Although the banks can argue that they acted strictly according to the covenants, it was not a sensible, logical approach – 'they went with the herd instinct'.

Case 15:
No, not at all. They are operating in an extremely successful area of the construction market. They could have reduced risk by agreeing a pre-sale and the company also has the capacity to hold property and manage its rental in cases where property sales get delayed. Furthermore, in their opinion it was a watertight arrangement in a high value central London location with excellent sales potential.

4.6 Factors that contributed to the business having difficulties

Declining sales/ profitability:	6
Over leveraged (too much outstanding debt):	3
Lack or insufficient security:	5
Poor credit score:	1
Risky/ unproven project:	3
Sector:	4
Bank policy:	7

When asked about the factors that had contributed to them having difficulties with their banks, bank policy again emerges as the most commonly mentioned factor, but almost as many FDs mentioned the declining sales and/or profitability of the business and the lack of sufficient security (partly attributed to falling commercial property values in two cases).

It is also worth noting that four businesses thought that their sector counted against them. These included: a travel agency which made an unsuccessful application for an overdraft, this being attributed to the low overheads and low security provided by this type of business; a construction company that had a loan application turned down, this being attributed to the poor performance of the construction sector in general; and a brokerage business that felt that the nature of the business required a large amount of leveraging for up front working capital.

4.7 Assistance with application

Half of the businesses had received some assistance from the bank with their application. For three of them this took the form of discussions with their relationship managers about their finance requirements and advice about putting the application together. One firm had what it described as very positive meeting with the bank's senior credit committee before going through a long due diligence process that resulted in its application for a second loan being rejected. In three other cases the bank was described as being very proactive in providing guidance and help, whereas in another instance professional advisors were sent in although not welcomed wholeheartedly by the firm itself.

Case 2:
The bank RM has had meetings with them and assisted with applications. There has been plenty of paperwork and in recent times it has quite often been incorrect, resulting in additional letters and delays.

Case 11:
The bank kept sending along professional advisors to tell them what they already knew and this just cost the business an additional £50-100k in professional fees for bank accountants.

Case 15:
Initial meeting with the bank's Mez finance and Senior finance credit committees went well and bank showed appetite to lend 85% to value on both £20m loans required. They passed through first stage credit committees and then a long process of due diligence ensued when underwent technical analysis – still very positive after two months. In the final month they went through final stage credit committee where one person from the risk committee indicated that they would not support the second loan – resulting in a knock-back on the second loan after three months.

4.8 Length of time to get a decision

Not long: 1

< 1 month: 2

2-3 months: 5

4-6 months: 2

7-12 months: 3

over 12 months: 2

In seven of the 15 cases it took up to three months to receive a decision, whereas in the other eight it took four months or more. The longer periods are generally associated with those businesses that disputed the banks offer and have spent several months trying to negotiate a better deal. Whilst the banks initial decisions were normally made within a few weeks, this was followed by several months of negotiation. For example, it took one company six months to negotiate the reinstatement of its previous overdraft but it was still, at the time of interview, trying to negotiate a reduction in fees. Rather exceptionally, another company said that it took 18 months to reach a decision because of the complex nature of the financing structure, involving a number of interested parties, whilst the registered charity case had spent two years in discussion with their bank without resolving the legal problems pertaining to letters of credit.

Case 2:
It took 6 months to reinstate the overdraft and they are still in dispute over fees, as the bank wanted to charge another arrangements fee of 1.5% of overdraft value (i.e. £15k), but this was for a pre-existing overdraft (which the bank had reduced).

Case 5:
Initial discussion took about a week to prepare for in terms of getting annual accounts and reports together. The bank's response was quite quick, within a week, but the ongoing negotiations to lower bank costs of finance took a couple of months to resolve.

Case 14:
Applications were simple and straight forward with their existing bank, simply requiring meeting/discussion with RM and then submitting requirement to central credit committee. Decisions were always made within 2 months – which was fine. However, their new bank required meetings and full and thorough due diligence. The application process took many months and they also dragged out their decision, so that the whole process took well over 6 months.
Subsequently met their new RM at end of August 2010 and put in another application for increased invoice finance to £6m, which after 2 months was agreed in October 2010. However, the FD is unhappy that there is a set-up fee of £9k (for additional £2m), when it previously in 2008 only cost £7k to raise £4m. This point is currently under negotiation.

4.9 The Cost of the Banking Offer

Two-thirds of surveyed businesses (10 of 14 cases where bank finance was sought) were unhappy about the cost of bank finance offered. Whilst some complained about the increase in interest rates, which rose by between 1.25 percentage points and 3 percentage points above base from what was previously set, the most vocal complaints about interest rates came from those being offered new financial services such as invoice financing and mezzanine finance – the latter being set at 10 percentage points above base in one case. That said, most respondents accepted that they had to pay market rates of interest.

The main source of complaints about the banks finance offer was in relation to their charges. Some complained about the increase in set-up fees which had typically risen from 0.5 per cent to as 1.5 per cent or 2 per cent of the finance offered. In some cases this had led to set-up charges rising by around £100k – which was deemed unacceptable by the business. One business complained that being charged an additional set-up fee of £9k on a service which already existed was not acceptable. There were also complaints about the maintenance charges imposed by invoice finance services which could be £5k per month. One business also complained that their bank had tried to impose an additional low use charge on their invoice finance service. One respondent also complained about the introduction of new back-end charges which made early repayment and refinancing prohibitively expensive.

On balance all 10 cases would appear to have good reason to be dissatisfied with the increasing cost of bank finance that was offered. However, this may in part be due to the fact that they had become accustomed to the cheap finance available in the pre recession era.

4.10 Alternative Sources of Finance:

Just one third of the 15 cases considered using alternative external sources of finance to bank debt finance. The range of sources of finance considered included: three cases of private equity, including one flotation; one case of mezzanine finance; one case of R&D grant finance; one case of joint venturing; and one case of land bank finance. Additionally, two businesses referred to raising finance through associated business trust finance.

The majority of cases did not entertain the idea of equity and mezzanine finance because their businesses were considered to be family owned operations with no intention of sharing equity. Two businesses specifically mentioned that now is not a good time to seek private equity and that a flotation would be out of the question in the current economic climate.

In all cases (except for a discouraged borrower, with no collateral/property for security – which had floated on AIM to raise equity finance) bank finance was sought in the first instance, because debt finance from banks was the preferred option. One business opted for a combination of bank debt finance and equity investment.

5. IMPACT OF REJECTION/DELAYS IN BANK FINANCE

a) Impact on business plans

Have not gone ahead at all, in any format:	0
Gone ahead at the same time, but on a smaller scale:	6
Has taken longer to go ahead, but at the original planned scale	3
Has taken longer to go ahead and on a smaller scale:	2
Have gone ahead at the same time and at the same scale:	4
Business is under increasing threat of closure (please explain):	0

The interviewed FDs were asked to assess the impact on their business plans of not being able to raise debt finance (in full or part), or as a result of delays in obtaining finance. Just four of the 15 businesses considered that they have been able to go ahead unaffected, all the others being affected in some way.

In the case of the six businesses that had gone ahead but on a smaller scale, the reduction in the overdraft facility and hence availability of working capital resulted in cutbacks having to be made in some cases, with one business having to reduce the scale of its new franchising activities and another being unable to service larger orders. Others stated that the increase in banking costs would slow down the development of the business coming out of the recession.

In the case of the three businesses where it had taken longer to go ahead, but at the planned scale, the delays resulted from the uncertainty and management time taken away from business development activities during the months of negotiation with the banks. Long delays in reaching an acceptable solution for the business also contributed to the difficulties faced by the two businesses that took longer to go ahead and on a smaller scale. In one of these businesses the delay in obtaining the finance meant that the business it was planning to acquire went into liquidation and therefore had lost much of its trade by the time it was possible to complete the takeover.

Even though four businesses said that they had been able to go ahead at the same time and at the same scale, they anticipated that the additional bank charges involved would reduce profitability in the medium to long term.

Case 2:
The main impact of the bank reducing the overdraft facility for the business and delaying reinstating it has been to force the business to make more cutbacks and reduce the scale of the new franchising activities. This meant that the franchise was not set-up as well as it could have been (i.e. did not have a proper customer database set-up to maintain and develop customer relations) and trade was restricted for the first 6 months – probably costing the business £3-4m off top-line sales turnover.

Case 6:
Knowing that they could not raise bank finance and with no other likely sources of finance, they have had to sell £500k asset part of the business to raise funds. This has resulted in a loss of £500k annual sales income, effectively wiping out the profitability for the current financial year.

Case 12:
Have gone ahead, with minimal impact on the business, although the additional cost burden of finance will impact on the bottom line profitability. However, the reduced exposure to debt finance and group restructuring means that the overall impacts are negligible. There has been some management time wasted in negotiations. Overall the view is that this has soured the relationship with the bank and that they will now seek to reduce their use of UK banks and look to group financing and European bank finance, which may be more cost-effective.

Case 13:
The Letters of Credit problem has held back the business, because of the lack of certainty underpinning the credit line of the business. Therefore they are unable to raise funds beyond their own resources – that said the market has been quiet and therefore few opportunities for growth/development.

b) Impact on sales turnover

Not affected: 4

Increased: 0

Decreased/Restricted: 8

DK: 3

More than half (8) of the interviewed FDs considered that their difficulties with the bank were having a negative impact on sales turnover. For example, one business estimated that sales turnover will be 20 per cent down on what it would have been because of the delays in obtaining finance, and another estimated it would be 10 per cent down. Only four considered that the difficulties were having little effect, and another three thought it was too early to tell.

c) Impact on profitability

Not affected: 0

Increased/Improved: 1

Decreased/Reduced: 13

DK: 1

All but two of the interviewed FDs considered that their difficulties with the bank were having a negative impact on profitability. This was attributed partly to reduced sales turnover and partly to the increased costs of bank lending. One business (a travel agency) stated that the failure to obtain bank finance had necessitated the sale of £500k of assets and the loss of £500k of sales income, effectively wiping out profitability for the current financial year. Another business (a steel manufacturer) referred to the impact on profitability of having to resort to expensive short term floating finance arrangements for over a year because of the delays in agreeing a refinancing package with its bank. Interestingly, one business thought that the changes that the bank required to the business would help restore profitability (see case 1 below).

Case 1:
In hindsight, the business may have come out of this quite well as it forced them to review the business, get independent financial management advice from auditors' corporate restructuring team and make some important cutbacks (i.e. reducing stock, reducing overheads and redundancies) – returning the business to profitability, albeit at a lower sales turnover level. Whilst debt finance has been squeezed, the business has not agreed to paying new fees and is now in a much stronger position to renegotiate terms than 7 months ago

Case 5:
There has been an impact – mainly stress and cost of negotiations initially – but longer term it will undermine business profitability with the increased costs of finance that the business has to operate with. Profit margins will be squeezed by the increased overhead costs of finance by at least £150k.

Case 15:
Reduced potential profitability by up to £4m due to the cost of borrowing from the company's Trust.

d) Impact on employment

Not affected:	9
Increased/Improved:	1
Decreased/Reduced:	4
DK:	1

Most of the interviewed FDs considered that their difficulties with the bank were not affecting employment within the business. Four businesses stated that there had been a reduction in employment as a result of the difficulties experienced in raising bank finance. The largest employment impacts applied to a firm that had to cut back its activities as part of a refinancing package to reduce the amount of debt in the business, leading to employment being reduced by more than 50 FTE staff (almost a quarter of its workforce). Another firm that responded to the bank's decision to call in its loans by selling assets reduced its employment by 25 fte staff (almost a third of its workforce).

6. RESOURCES AND STEPS TAKEN TO IMPROVE ABILITY TO OBTAIN EXTERNAL FINANCE

6.1 Internal Resource Experience

All 15 businesses had experienced Financial Directors (FDs) in place with considerable experience of accessing various forms of bank debt finance. One referred to having gone through four rounds of financial restructuring with the banks during his career with the firm. Thirteen businesses had FDs that were fully qualified Chartered or Certified Accountants, with one part qualified and the other having 25 years experience. Only two businesses did not have a treasury function or specifically designated finance department and one of these was a commodity brokers with only 14 employees. In addition to the FDs, three businesses had NEDs with considerable financial management experience, including two with banking experience and one FD specifically mentioned that the company CEO had considerable financial management expertise.

The businesses were less experienced with regard to sourcing other types of finance and only six mentioned specific examples: four cases of equity and VC finance, including two flotations; one case of leasing finance; and one case of grant finance.

6.2 Types of external assistance used

Signposting	2
Business Planning	8
Business Presentation	6
Financial Negotiation	8
Professional and Legal Services	14

All of the businesses (except for the ‘discouraged borrower’ which did not apply) referred to using external assistance to support their applications for bank finance. In all cases this referred to the use of accountants and auditors to provide full financial information to support the application (i.e. audited end of year accounts, financial projections and business plans) and solicitors who assisted with legal contractual work. Other professionals mentioned included surveyors reporting on property security and venture capital consultants helping to find sources of equity finance. A majority of respondents mentioned the importance of accountants and associated corporate restructuring advisors in assisting with business planning, presentation and negotiations.

6.3 Knowledge and Management of Credit Rating

Twelve responding FDs stated that they were aware of the business's credit rating, by keeping track with Dun & Bradstreet or Experian.

Two-thirds of the businesses have taken steps to manage and improve their credit rating. This has involved ensuring that payments are made on time, regularly communicating with creditors and banks and ensuring maximum financial transparency.

One manufacturing company FD stated "*we are aware that our rating dropped during the finance crisis and have taken steps with credit insurers and agencies to demonstrate our business is in a healthier, more stable position now – ensuring accounts are filed on time and providing information wherever required."*

7. FUTURE POLICY GUIDANCE

7.1 Views on need to improve access to finance

The interviewed FDs were asked for their opinion about what aspects of current finance could be improved, based on their recent experience. Only seven of them responded to this question but their answers reflect an overall desire for bank policy to be more attuned to the needs of businesses, with several implying that the modern banking culture has become divorced from that of businesses.

Need for longer term finance:	2
Need to separate commercial banking from investment banking:	2
Bank staff need to work more closely with business clients:	1
Anything that would improve availability of finance to business helpful:	1
Need to get back to basics of commercial lending:	1
Reduce up front deposit requirement on project funding:	1

Case 2:
The business has only been interested in using bank debt finance. It is a family run and owned business. As such they feel that a real problem lies with the blurring in recent times of business investment banking with business banking. In effect the banks have let down their retail commercial banking customers. Bank staff need to be more than merely form fillers, dealing in finance scorecards, they need to know about their business clients and work with them in a way that goes beyond investment banking models.

Case 4:
Bank services need to be broken down between (i) investment (ii) commercial lending and (iii) transactions. Banks have become big conglomerates where a few banks do everything. Banking needs simplification – they have lost their focus on core business offer. End user commercial clients are now being asked to subsidise banking to make up for the failures of investment banking.

Case 7:
The firm is only interested in using bank debt finance. Their bank behaved poorly and in their opinion without justification. It is interesting that they were able to secure a very good full financial package with a rival bank, although the respondent mentioned that he was aware that whilst one regional team of the bank was very helpful, he is aware that one of their other regional teams in a different region have not been so helpful to another vehicle trader business that he knows well – so there is some regional variation within the same bank. Need to get back to basics of providing commercial banking/lending services and allowing businesses to operate.

Case 15:
They have experienced a squeeze on lending from their banks as they have actively sought to reduce their exposure to debt and reduce gearings. The business is fighting to retain the status quo, rather than increase borrowing with main bank. The banks' loss of appetite for lending has been experienced with the failure to obtain a perfectly good second £20m loan with another bank that they have a long standing banking relationship. Furthermore, there are increasing costs to borrowing and more restrictive terms of borrowing – for example the demand for up to 30% of project finance in up front deposit is putting pressure on construction projects and cash-flow, plus the demand for pre-sales is reducing scope to negotiate better prices for property sales. Have noted in recent dealings with another bank that they are introducing more management/admin fees and higher charges, including commitment fees from day one. Due diligence requirements are also becoming increasingly complex and restrictive. The main banks need to take a longer term view of funding strategy.

7.2 Views on role of Government

The interviewed FDs were also asked in what ways they thought that the government can act through policy instruments to improve the current finance system. Eight of them responded to this question, with some of their answers indicating a need to reform the banking system in order to encourage more competition between banks and to encourage

banks to take a longer term view of the financing needs of businesses, based on a sound understanding and knowledge of particular sectors.

Government should encourage longer-term lending:	2
Not in favour of government intervention:	1
Need for more banking competition:	2
Anything that can generate more finance for businesses:	1
Less centralised decision-taking in banks:	1
Banks need to relax their lending criteria:	1

Case 1:
The government could provide some form of guarantee for banks which would encourage them to take on longer-term strategic lending.

Case 4:
Banks have lost their focus and there is now an unhealthy relationship with businesses. The banking industry is a closed market and we have ended up with a small number of quasi cartel banks in a small club which can dictate terms. There is lack of banking competition. The result is not healthy for UK business. Believes that the VC market sucked cash into it, resulting in reduction in commercial finance.

Case 5:
There used to be many forms of bank finance and banks to choose from, but now there are very few banks and services to choose from and little competition amongst banks. The banks are providing so many restrictions and guidelines that it restricts lending. This is mainly down to bank policy which results in less lending and less take up of bank finance offered.

Case 12:
"The banks are raising profit as aggressively as they can. The attitude of banks is such that the company is reducing its exposure to bank finance and therefore not seeking to borrow from them." Anecdotally, it was suggested that several of their customers had mentioned that the banks had been doing anything they can to raise the costs of finance – overriding pre-existing agreements wherever possible.

Case 15:
Overall, as a business they have to be prepared to pay the market price for borrowing in order to exist. Their main complaint is that the banks are not taking a more considered view, not just immediate, but taking on board the short to medium term picture and enabling them to operate effectively. They also need to understand that some areas of construction are currently successful.

8. CONCLUSIONS

This follow-up, qualitative study of 15 businesses that reported problems accessing bank finance as part of the 2010 Finance Survey of Mid Cap Businesses has explored the nature of the difficulties businesses experienced raising finance in greater detail than the main survey. It is important to acknowledge that these experiences are not necessarily representative of the vast majority of mid-cap businesses that can successfully obtain finance, but this qualitative research offers a useful insight from the perspective of businesses that are currently experiencing difficulties raising finance. They were all long established businesses covering a broad size range within the ‘mid cap’ definition and drawn from a wide range of sectors.

Although nearly all the 15 companies managed to obtain at least some bank finance over the last three years, they differed in terms of how successful they had been in 2010. Just over half of them obtained bank finance in 2010, four of them receiving all the finance they required and another four obtaining less than they were looking for, although not necessarily from the first bank that they approached. Another three businesses were still waiting for a final offer from the bank at the time they were interviewed. This leaves four firms that did not obtain the bank finance that they sought, either because their application was rejected, they were discouraged by the bank from applying, or the bank wanted to reduce their existing loans to reduce debt exposure.

For most of the 15 companies, the main problems related not so much to their ability to raise finance, but to the delays in reaching an acceptable offer from a bank and over the terms and charges that the bank wanted to impose. Several rejected the bank’s first offer because they found the terms and fee levels unacceptable in relation to their previous experience. They then either proceeded to try and negotiate better terms or approached other banks to see if they could obtain a better deal. Other businesses complained that their bank wanted to restructure their finance to reduce debt exposure, shifting the emphasis away from less expensive overdraft finance towards more expensive invoice financing. Most of the businesses attributed their difficulties to recent changes in bank policy, which they considered to have become more demanding, costly and less personalised, although some also recognised that the poor performance of the business had been a factor.

A key question underlying this study is whether or not the ability of good quality mid cap businesses to contribute to the economic recovery is being constrained by the difficulties of accessing bank finance. To help to shed some light on this question the 15 businesses were examined in terms of their sales turnover and profitability performance over the last three years and the outcomes of their lending applications. In terms of their recent business performance, the 15 businesses fall into three broad performance categories: (i) successful – where the business is comfortably in net profit and sales turnover performance is holding up or increasing; (ii) moderate – where the business is in net profit, but sales turnover has been erratic; and (iii) poor – where the business has been loss making or at breakeven and sales performance has been static or erratic.

All five of the successful businesses were able to obtain finance in 2010, albeit after a period of negotiation over terms and bank charges, or in two cases using other sources. However,

the difficulties these businesses experienced in the process of obtaining the finance negatively impacted on sales turnover (in two cases) and profits as a result of the increased cost of finance (in three cases). All five of the moderately performing businesses also managed to obtain at least some finance in 2010, although less than they were originally seeking in three cases, whereas the other two cases eventually obtained all that they required by going to another bank. The difficulties experienced by these businesses were considered by four of them to have constrained their growth and development. The five businesses in the poorly performing group were the least likely to obtain bank finance, being refused finance or experiencing a significant reduction in the amount of lending that their bank was prepared to offer. This had a significant negative impact on these businesses, including the forced sale of assets and loss of income, the shelving of plans for further development, a loss of credit rating, and a loss of profitability.

It can be concluded therefore that there is some evidence from this study that the difficulties associated with the process of obtaining bank finance are constraining the growth and development of a relatively small number of successful and moderately performing mid cap businesses. Although there appears to be obvious reasons why some businesses had difficulties obtaining finance, it was not obvious why the more successful mid cap businesses should experience difficulties.

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APPENDIX I: SUMMARY OF DIFFICULTIES IDENTIFIED BY EACH OF THE INTERVIEWED MID-CAP BUSINESSES

Case 1:

(Distributor of commercial vehicles and plant machinery; empt 150; t'over around £25m)

- Bank wanted amount of debt in business to be reduced and for a re-structuring of finance.
- Increase cost of finance (4% points above libor and annual maintenance fee).
- Slow pace at which bank moves.
- Bank wanted earlier repayment of term loans (3-5 years rather than 7-10 years).
- Business had to retrench and contract to a smaller scale of operation.

Case 2:

(Engineering; empt. 140; t'over £40m)

- Difficulties in maintaining their existing level of bank finance (2-3 yr loans + overdraft).
- Bank policy to reduce exposure to debt led to cut in overdraft facility and reduced invoice financing.
- 5 months of negotiation to reinstate overdraft facility.
- Had good understanding with previous RM, but then replaced by 'paper pusher'.

Case 3:

(Engineering; empt. 100; t'over £40m)

- Bank unwilling to lend amount required.
- Bank worked to change type and structure of lending (overdraft changed to term loan + invoice finance).
- Offer considered unsatisfactory therefore not accepted.
- Negotiations (ongoing) over 7 months.
- Poor performance of non-British parent company led to forced sale of overseas subsidiary.
- Made significant loss in '08.
- Considers the bank is not correctly assessing the risk of finance.

Case 4:

(Sports & Conference Centre; empt. 250; t'over £15m, part of much larger group)

- Excessive cost of acquiring bank finance compared with before (set up fee much higher).
- Had not expected the level of toughness from the bank.
- Long time taken to negotiate terms of loan (3 months).
- Everything referred to bank's central decision-making unit.
- Eventually negotiated a deal that accepted (at higher interest rate).

Case 5:

(Discouraged borrower)

(Travel Agent; empt. 140; t'over £60m)

- Bank unwilling to provide overdraft finance (despite being customer for 20 years).
- Did not get to stage of discussing terms.
- Problem relates to the sector (travel industry experiencing difficult times) and lack of assets (no premises or stock value).

Case 6:

(Commodity brokers; empt. 10; t'over £110m)

- Cost of combined loans and overdraft compared to previously (increases in annual facilities fee and interest rate).
- Bank had new financial model showing risk level of business had increased.
- Excessive securities and personal guarantee required.
- After 2 months of negotiation managed to reduce facilities fee slightly.

Case 7:

(Vehicle retail and rental; empt. 190; t'over £60m)

- Request for overdraft facility (summer '08) originally agreed but then (Feb'09) bank reduced offer and increased the cost (additional facilities & administrative fee), led to 3 months of negotiation.
- Eventually obtained finance on much better terms from another bank.

- Bank (that had used for 5 years) effectively capped growth and took an aggressive stance to debt repayment.

Case 8:

(Transport; empt. 480; t'over £60m)

- Have used 4 banks to raise cumulative revolving term loan debt.
- Approached 1 of the banks about obtaining an additional loan, but terms were unacceptable (1/2 length sought and set up fees + interest rate too high).
- Terms and conditions more stringent then expected.
- Spent 5 months trying to negotiate, but got nowhere.
- Bank had covenants against firm which could lead to loss of control.
- Eventually obtained finance from another bank – proved much easier.

Case 9:

(Property Developer; empt. 50; t'over £20m)

- Had operated using 5 year loans from 5 banks.
- One of banks wanted to call in loans within 3 months, led to having to sell assets.
- Costs of borrowing increased disproportionately to risk.
- Banks now charging back end fees (i.e. early repayment / transfer penalty and renewal fee).
- Crippled by bank end fees and increased margins of bank lending.
- Future bank loans for development projects becoming too expensive to consider.

Case 10:

(Steel manufacturer: empt. 350; t'over £40m part of much larger group)

- Company had re-financing requirements (to cover cash flow & working capital).
- Security level relating to overdraft went from light touch to 100% (not acceptable).
- Bank said overdraft financing no longer cost effective, therefore could only provide loan and invoice financing.
- Intensive negotiation process as involved several interested parties – took 18 months.

Case 11:

(Distributor: empt. 450; t'over £90m)

- In '08 raised finance from syndicate of 4 banks + VC investor to finance MBO.
- Covenants etc drawn up pre-recession and did not provide sufficient tolerance.
- Failure of one of the firm's customers to pay on time resulted in the bank deciding to cut back on debt exposure.
- Bank required additional security, higher interest rates and more stringent covenants.
- 6 months of negotiations got nowhere.
- Ended with a trade sale to a US company.

Case 12: *(discouraged borrower)*

(Manufacturer of plastic products; empt. 150; t'over £25m)

- In '08 obtained package of finance from bank (included mortgage + invoice financing) - banks were then keen to do business at competitive rates.
- Subsequently the bank wanted to re-negotiate terms and conditions of lending.
- Reduced invoice discounting cap and increased maintenance charges and reduced mortgage level.
- Feels that their bank needs to take a longer term view of business performance.
- Has become a discouraged borrower – will seek to reduce use of UK banks.

Case 13:

(R & D; empt. 650; t'over £40m)

- Difficulties result from not being on orthodox business case.
- Letter of credit sought from bank – but covenants not suitable for a charitable business.
- Bank came up with very expensive mortgage solution, but considered unacceptable as too expensive.
- Process been going on for 2 years – still unresolved.
- Now discouraged from considering bank finance.

Case 14:

(Importer/ Wholesaler; empt. 70; t'over £100m)

- In '08 sought overdraft facility but offered invoice financing instead.
- In 09/10 wanted to increase credit line to assist with acquisition and fund stock purchase.
- Bank wanted to impose a further set up fee for the additional finance, but considered unreasonable.
- Tried alternative bank, but took 6 months to arrive at a negative decision at considerable cost to the firm.
- Both banks refused additional finance as proposition considered to be too risky.

Case 15:

(Property Development/Construction; empt. 250; t'over £140m)

- Sought short term-loan finance in 2010 for 2 development projects from existing long-standing bank.
- Faced longer than expected, more rigorous, due diligence procedures than previously experienced.
- After 3 months only offered term loan finance for one project, due to perceived risk and over exposure to debt finance. Too late to seek alternative bank finance.
- Business feels that it has excellent track record, working in currently successful area of construction sector, and has ability to secure and manage development risk, as it can afford to hold property and manage rentals itself until property is sold.
- Business was able to secure alternative financing, but lost potential £4m profit on project.