

# **The impact of the credit crunch on UK businesses**

## **Introduction**

In October and November 2008 ICAEW Regional Directors visited chartered accountants in business and practice across the country. Issues relating to the economy were also discussed at length during meetings of ten Regional Strategy Boards across England and Wales.

This adds up to a revealing commentary on the current economic picture. It catalogues many situations where banks appear to be reducing or withdrawing financing facilities.

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## **Impact by sector and region**

### **Retail**

Trading conditions very difficult. Retailers are extremely nervous about what they expect to be a very poor Christmas and New Year trading period. Value retailers, however, are doing very well, as are the very top end, luxury retailers. One Chartered Accountant reported his firm's Bond Street and similar luxury retail clients were seeing booming sales. There is a whole section of retail on hold – the high value, discretionary purchases such as cars, caravans and boats. Few consumers are choosing to buy now when prices may be lower in a few weeks' or months' time. – *East Midlands*

Retail trading conditions are tough – it is still possible to sell everyday/cheap items but not luxury/expensive ones (e.g. new kitchens, bathrooms, etc.). – *South West*

The DIY market is booming, although this is at the expense of Home Improvement tradesman, as people decide (literally) to do it themselves. – *North West*

### **Automotive**

The Toyota plant in Derby has moved to a four day week, two major car dealerships have announced job losses of 1,000 and 500 respectively, a number of smaller dealerships have already laid off sales staff. Whilst sales of new cars are down, the servicing and repair side is busy, as customers delay the replacement of their vehicles. – *East Midlands*

Ford Bridgend announced temporary lay-offs due to a drop in demand. – *Wales*

The motor industry – particularly German motor cars – is still strong. – *South East*

New car sales have plummeted and manufacturers are introducing shorter working weeks and a much longer Christmas holiday period, up to four weeks in some cases. – *North West*

Car retailers are struggling to move stock and will contract significantly. – *Northern region*

Rumours abound that Jaguar-Land Rover will suspend all production for three months. – *West Midlands*

### **Manufacturing**

The cost of manufacturing overseas is increasing relative to UK and firms are winning orders as a result. Companies which manufacture overseas are considering bringing some work back to the UK, on price and quality criteria. A number of manufacturers have seen the recession coming and acted early to mitigate the effects. However, order books are now falling. – *East Midlands*

There have been significant job losses across Wales, including those at Calsonic in Llanelli, at L'Oréal in Llantrisant, at Budelpack COSi in Maesteg, at Ivor Williams's trailer company in Denbighshire. – *Wales*

The current economic situation is biting hard already on manufacturing. – *South West*

A local company is seriously looking at starting to manufacture white goods in County Durham. It is claimed that the labour content is less than the cost of shipping from Turkey. – *Northern region*

University spin-out from Durham may be a spectacular growth company with its TOPLESS product – thin organic polymeric light emitting semiconductor surfaces. Early phase will be marked by creation of high value jobs. – *Northern region*

Two traditional metal-basing businesses have seen increases in work because rising costs, higher transport costs and unreliable quality in the Far East are leading to a repatriation of business. There is view that this is part of a trend. – *West Midlands*

## **Agriculture**

Arable farmers have been hit by increased fuel costs as a result of having to dry crops during the wet summer, a fall in the price of cereals and a huge rise in the price of fertiliser. – *East Midlands*

Farms have had a disastrous 2008, due to a very wet summer. Next year's planting is late so already there is expectation, if no little certainty, that 2009 will also be a bad year for farms. – *Northern region*

## **Property and construction**

New house builders and any businesses related to the property sector are suffering a serious drop off in work. Reports of related businesses forced to lay off staff or close in recent weeks include estate agents, conveyancers, removal firms, carpet and white goods retailers, and haulage for the building trade. However, construction companies not dependent on new house builds, are coping with the downturn. – *East Midlands*

A major redevelopment of Cardiff city centre is due for completion next year, and there are concerns about the low level of take up of units to date. Many large housing developments (in Cardiff and Swansea) have been mothballed, and there are signs of a melt down in the buy to let market, with apartments failing to sell at auction even at low reserve prices. – *Wales*

A large number of property developments remain empty and a deflationary glut of buy-to-let cheap apartments is expected in the next 12-18 months. – *North West*

One local construction company, not involved in residential construction, is growing by acquisition and is pleased the market has created opportunities to acquire good companies whose owners seek an exit. – *Northern region*

Some London construction businesses are insulated from the effects of the downturn by the 2012 Olympics activity. Other construction work at Ebbsfleet, and into the future Crossrail were also mentioned as helping reduce the effects of the downturn in London. – *London*

There have been several reports of commercial property owners ripping off roofs or demolishing whole buildings to avoid paying rates on empty property. – *West Midlands*.

## **Professional services**

Solicitors' and surveyors' practices are very short of work – there have been some redundancies. This is not an issue for accountants yet. – *South West*

The financial sector is in the process of major structural change and there will be 'substantial' cuts in jobs and retail outlets as banks amalgamate following recent mergers and takeovers. – *North West*

Some sectors – professional services, estate agents, mergers & acquisitions – are already seeing increased failures. Other examples of professional services businesses cutting back include as surveyors and publishers of professional journals. – *London*

The most affected sector in London is the financial one. It is also affecting the property sector. As an example, chartered surveyor firms recruit 20/30 graduates to be trained in their firms but once the training contract is completed only an average of two people get a job in the firm. The major banks (ING, Goldman Sachs) are cutting back substantially. – *London*

## **Tourism**

The tourism sector is suffering badly. – *Wales*

The tourism sector did poorly last year and is expecting poor results in 2009. However, poor exchange rates may persuade people to stay in UK if the weather looks good. The sector expects many consumers to make last minute choices. – *South West*

## **Public sector/third sector**

The Third Sector is in part dependant on funding from the Assembly and has concerns that funding will be squeezed, to their disadvantage. – *Wales*

Concern that economic circumstances are adversely affecting public sector's ability to support/invest in regeneration and infrastructure projects needed to improve economic performance and competitiveness. – *South West*

Watch out for economies in the public sector – job losses could be just as severe there – one University cited sharp increases in salary and utility costs as the key factor in some 200 job losses recently announced. – *South West*

The environment energy sector is doing well, principally because there is long term investment already in place, much of which is supported by central government. – *North West*

## **The availability of finance**

In the case of a company supplying home-ware, the bank reduced the overdraft by one-third and refused to re-assign a personal guarantee on the departure from the board of the guarantor. As a direct result, the company called in receivers. The personal guarantee is being exercised and the business is unlikely to be sold as a going concern. – *West Midlands*

A manufacturing company which employs 110 people has been asked HSBC to pay off its £75,000 overdraft. It is likely the company will close as a result. – *West Midlands*

Allied Irish, wants to renegotiate the existing loan to a charity with a very strong asset base from base +1.5 per cent to Libor +3.5 per cent and charge four times the normal arrangement fee. – *West Midlands*

When a profitable company found its overdraft at a temporary low point, HSBC immediately and without warning reduced the facility to its current low point. – *West Midlands*

RBS pulled an overdraft for a small business when its overdraft was temporarily at zero. In this case, staff agreed to work unpaid for one month before the business received money due from a major customer. – *West Midlands*

Banks are raising their interest rates, fees and charges. Because of the downturn, predicting sales, profits and cash flows has become more uncertain. There is therefore greater risk, and this is making the banks more cautious. – *Wales*

Many businesses are turning to Finance Wales who are reported to be very busy (Finance Wales is a small investment bank, set up with European funding, and managed by the Welsh Assembly). There is a feeling that Finance Wales will be more understanding of the difficult economic position; their interest rates are higher than banks, but they will lend unsecured, which banks will not. – *Wales*

Corporate finance activity has practically ceased. This is regarded as the consequence of the banks' refusal to lend. "Corporate finance has died. There's no money out there". – *East Midlands*

Certain corporate finance deals are still happening, such as the sale and purchase of large corporates' non-core businesses, at the £25million to £50million level. However, good deals are failing to happen because they cannot be financed. – *East Midlands*

The relationship between the small business and its bank is very difficult at the moment because the local corporate banker appears to have no authority and is micro-managed by his/her head office. – *East Midlands*

Personal guarantees are often required where they were not expected and the amount of security demanded is higher than anticipated. "At the moment things are hard if you are borrowing". – *East Midlands*

When Advantage West Midlands announced a £4 million turnaround fund for SMEs in financial difficulty, the agency received 100 inquiries in two and a half days. – *West Midlands*

Smaller firms trying to raise money were experiencing difficulty and it was reported that any firm needing to renegotiate finances over the next 12 months 'would be in for a big shock'. – *South East*

Bank lending has tightened. Rates are higher and risk-assessment has tightened, and this includes existing customers. Indeed, there is evidence that the banks are using the credit crunch to make borrowing much harder for their less strong customers. – *North West*

Some businesses have seen an easing of credit. A major supplier to the construction industry says it is now business as usual after a scare in the summer. – *West Midlands*

A medium-sized construction company successfully re-negotiated its credit facilities with its bank. – *West Midlands*

Senior Barclays staff feel the bank is being more prescriptive, and making a different charging profile according to risk and history/trading relationship. – *Northern region*

A Venture Capital member confirmed, firmly, that they still have funds to invest. They are now fielding more enquiries; however the quality is, perhaps not surprisingly, lower with only 1 in 5 meriting investment compared to 1 in 3 at the start of the year. – *Northern region*

The Co-op Bank is the only one lending on a percentage over base rate; all others are lending on a percentage over LIBOR (which is more expensive). – *Yorkshire & Humber*

There have been frequent reports of clients being moved from overdrafts to term loans and/or invoice finance even if facilities are not due for review – especially those clients who are going to their bank to request an extension of an existing line; this may well result in a complete renegotiation of all banking facilities, and an unwelcome increase in rates charged. – *Yorkshire & Humber*

Lending decisions are being made 'further up the line', by more senior staff than would have been the case before the downturn; clients are also being expected to jump through more hoops before approval is given. – *Yorkshire & Humber*

Lenders are applying the 'letter of the law' over banking covenants and will use even technical breaches (such as accounts not being filed on time) as an excuse not to proceed with lending, or to renegotiate terms. – *Yorkshire & Humber*

Almost all lenders say they are open for business, and we were given examples of two corporate finance deals that have completed safely, with no more than a 0.5% increase in the rates being offered. – *Yorkshire & Humber*

Interest rates charged by banks still high, bad debts are increasing. The costs of defaults will be 3 to 4 times pre credit crunch levels. There will be insolvencies among large businesses. Consumer confidence is underpinned by house price inflation. – *London*

Lloyds TSB increased the service fee on invoice discounting by 4.1 per cent in June blaming inflation. Then increased the interest rate by 0.4 per cent in September. – *West Midlands*

Smaller firms report that there is still CF activity, but fewer deals happening. More work around the renewal of finance, where banks are variously reported as being far too risk averse and charging higher interest than previously – 4-5% over base is the norm where it was 2-3% over base. To add further fuel, renewal fees are also being increased significantly by banks. – *Northern region*

Small businesses with bank overdraft facilities coming up for renewal are finding rates increased from 2% above base rate to 4.5% above base rate as a minimum. This applies to all sectors and is soon expected to have an impact on small business profitability. – *East Midlands*

Banks' fees for arranging overdraft and loan facilities have increased enormously. One interviewee reported increases of "thousands". Another reported the most extreme case he had ever heard of – an arrangement fee of £1,500 last year had grown to £30,000 in the summer of 2008 on a facility of £3million. – *East Midlands*

At the larger end of the market, one example given was an arrangement fee in negotiation of £2-3million on a facility of £50million, which must be renewed in six months time when another fee may very well be charged. – *East Midlands*

Businesses have examples of overdraft and loan facilities being increased between 2 and 4% upon renewal and arrangement fees vary from £1,000 for relatively small amounts to 5% for amounts over £100,000. – *North West*

### **Knock-on effect on SMEs**

#### **Cash-flow**

Stable businesses finding issues paying VAT bills, and difficulties finding funding from banks. This combined with increasingly late payment, likely to cause business failures. – *South West*

Cash-flow has slowed as everyone is delaying paying bills. – *South East*

Bad debts, and the time to taken to pay and be paid for goods and services have all increased. Respondents felt that on balance the delays were, as yet, more a result of prudence and caution than an inability to pay – but this situation may well change. Several accountancy practices are working closely with clients facing challenges –in many of these cases there will be one or more recent invoices still unpaid; there is a looming choice between increasing exposure from continuing to act in the hope of nursing the client through, or seeking to reduce exposure but making it more likely that the client will fail as a result. – *Yorkshire & Humber*

#### **HMRC**

Many practices found HMRC were not exactly sympathetic! Some small businesses are struggling to pay VAT bills but HMRC using discretionary powers to penalise. This is putting small firms out of business unnecessarily. Given some leeway these businesses are viable. – *South West*

The more punitive powers of HMRC towards businesses already experiencing cash flow difficulties, is reported to have resulted in business failures. There are two

specifics: The first relates to late payment of VAT which, after three consecutive late payments, results in massive surcharges on the business; the second concerns HMRC's powers to withdraw the Construction Industry Scheme as a consequence of the employers' late payment of PAYE, causing severe and sometimes fatal damage to a business' cash flow. – *East Midlands*

### **Credit Insurance**

Refusal of orders not covered by credit insurance/payment in advance. There are two approaches cited: some are prudent and refuse to take the risk of a bad debt, others argue that they need the business and are prepared to take a chance. – *Yorkshire & Humber*

Credit insurance has been highlighted in relation to the US car-manufacturing giants but it is becoming a serious problem for SMEs, who insure their credit risks for peace of mind and sometimes because it is a condition of invoice discounting. – *West Midlands*

### **Effects on the Accountancy Practices**

Clients are paying their professional advisers more slowly. They, in turn, are being more rigorous in their credit control procedures and collecting debts more aggressively. One accountancy firm calculated clients are taking an average of 15-20 days longer to pay. – *East Midlands*

Corporate finance people report activity, mainly in trying to complete existing deals, but also in refinancing businesses. Insolvency practitioners are very busy, but more on intensive care than insolvency. – *Wales*

A large firm of accountants has moved its corporate finance team onto insolvency work. – *West Midlands*

There is a time lag before economic conditions hit members' practices. However, bankruptcies are just beginning to hit and clients are questioning costs. Some firms are not planning to recruit as many students because newly qualifieds are not moving on. – *East of England*

Members in practice report a reduced enquiry flow and lower levels of new business but not to the extent reported in the media. It is also expected that the next 18 months will be difficult but others believe this was a longer term trend. Other practices reported no effect on clients but thought may be due to the offer of traditional services. – *South West*

Many practices are not expecting to make staff redundant but will not replace more senior staff when they leave as, with reduced business flow, practices are becoming top heavy. However, it was also reported that Corporate Finance business has halted and those practices are considering redundancies in that area. – *South East*

Firms are not owning up to any job cuts, however a member running a recruitment firm confirmed that practice is 'just not recruiting' at present. That situation is not repeated in industry where there continues to be recruitment of finance professionals. – *Northern region*

2008 student recruitment locally has held up close to 2007 levels. There has been positive reaction from smaller firms to the new LPD BDM recruitment outside the Big 3 is likely to increase in 2009. This will not be certain until after the August/September recruitment round. – *Northern region*

The profession is more sophisticated now than during last recession. Accountants are better trained and are able to offer more business services. The biggest barrier is that entrepreneurs do not trust advice because of fear. – *London*

### **Prospects for 2009**

No-one believes that this will be a short recession. The underlying causes and the lack of real solutions means that the recovery will be retail led, and it will take some time to restore consumer confidence. Most companies are looking at the first quarter of 2010 before any real signs of recovery and a few, mainly in the corporate events and hospitality sector are predicting a gloomy 2012. – *North West*

There is evidence to support the fact that Liverpool has bucked the trend to some degree but this is due largely to 2008 being the year of European Capital of Culture. Many believe that the city will have a harder time than other areas of the North West in 2009- 2010 as the reality of the recession hits home. – *North West*

Many companies are deciding not to replace staff who are leaving and will rely on 'natural wastage' as far as possible. However, many believe that redundancies will be inevitable as the recession settles in during 2009. – *North West*

Some companies feel that the pipeline of business is running out and are concerned about what might happen in 3-6 months. However, for some clients in the South East business is still booming. Practices are not seeing businesses adopting large scale redundancy programmes but the first enquiries on how to manage such programmes are trickling in. – *South East*

While members are aware of many businesses attempting to reduce their employee numbers, large-scale job losses are still rare; it is more usual at the moment to look for early retirements, or to seek not to replace a person who leaves. – *Yorkshire & Humber*

The current situation will not change at least until Q2 2009; it is not known when everything is going to be stabilised, confidence is knocking everybody. – *London*

Insolvency practitioners say demand for their services is only "steady" rather than overwhelming. However, they believe this is because many personal and corporate insolvencies are being postponed until after Christmas, either on the grounds that the festive season might just provide a financial lifeline or, in the case of individuals, that they may as well eat, drink and be merry while they can. – *West Midlands*

Start up enquiries are increasing. The RDA announced a £10m package of measures recently, including assistance for start up businesses. There is no sense from members that these enquiries include an increased proportion of distress start-ups. – *Northern Region*