

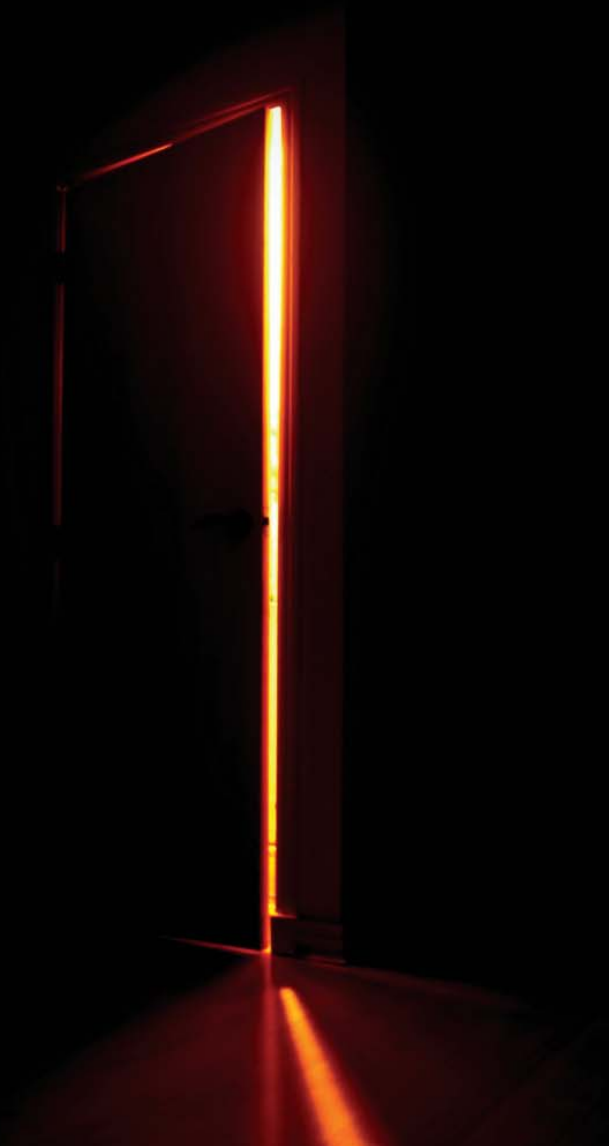


Ipsos MORI



# SME ACCESS TO FINANCE RESEARCH REPORT

JANUARY 2011





# WELCOME



The Chancellor recently told parliament that bank lending to small businesses is at the top of the list of issues he is monitoring. He is right to focus on SMEs; their growth will drive the UK's economic recovery. Financing that growth requires a good relationship between banks and businesses – yet our *SME Access to Finance* report suggests their relationship is breaking down.

Accountants are in a unique position to assess this relationship. They advise SMEs on how to approach banks, and where else to find finance when banks refuse. This report contains insights for banks, businesses and policy-makers on the current environment for access to finance. We also make recommendations on how relations between banks and businesses can be rebuilt, and how to improve access to finance overall.

The relationship managers dealing with SMEs should be empowered to take local decisions, fostering deeper relationships with their SME clients. Applying for loans should be a more transparent process, and banks should explain why applications are refused. SMEs need to demonstrate good financial management when applying for finance. They can also work with their accountants to strengthen their applications and find alternative sources of finance if required.

SME growth will be the foundation of economic recovery. Banks should work with SMEs and accountants to repair relationships and ensure finance is available to underpin the UK's recovery. Policy-makers have a major role to play in monitoring and supporting these efforts; we hope this report contributes to that work.

A handwritten signature in black ink that reads "Michael Izza". The signature is fluid and cursive, with the first name "Michael" and the last name "Izza" clearly distinguishable.

Michael D M Izza  
Chief Executive  
ICAEW

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# INTRODUCTION

In 2009, senior partners in the leading 30 or so UK network accountancy firms helped us to undertake an important piece of research on behalf of the Government to improve understanding of issues that affect access to finance for SMEs. The research was conducted by Ipsos MORI the independent market research agency, and the research report *SME Access to Finance* was published in July 2009.

In October 2010, we commissioned Ipsos MORI to conduct follow-up research in order to advise and update the Coalition Government on issues affecting the current SME environment for borrowing and investment.

This report is based on 21 in-depth interviews conducted between 12 October and 9 November 2010 among senior partners responsible for SME issues. In this report they are referred to as 'SME partners'.

When conducting this research we had support from a good spread of accountancy firms. The respondents had on average 15 - 20 years' experience in dealing with the SME sector, and typically dealt with 15 SMEs per month across a broad range of economic sectors and SME sizes, based in a spread of UK regions.

The findings complement the research conducted by ICAEW among businesses in the first half of the year on external debt finance. You can find this report, and other related ICAEW materials at [icaew.com/SMEFinance](http://icaew.com/SMEFinance)

# EXECUTIVE SUMMARY

## **SMES ADAPT TO THE NEW REALITY AND FOCUS ON THE FUNDAMENTALS**

The last 9 to 12 months have demonstrated the essential resilience of those small and medium sized enterprises that have survived the earlier stages of the recession.

With the future economic environment still unsettled, many SMEs are weathering the storm by cutting costs, managing cash flow more efficiently and avoiding further indebtedness.

## **DEMAND FOR CREDIT LOW AS SMES WAIT FOR SIGNS OF RECOVERY**

Demand for debt finance remains muted and is not expected to rise dramatically in the short-to-medium term while businesses continue to 'tread water'.

Most feel the picture remains difficult to read in the current economic climate. Compounding the prevailing uncertainty is the potential impact of the cuts to be made as part of the 2010 Comprehensive Spending Review.

But there is a sense that SMEs are poised to move into more aggressive mode once they are confident that the economy, or at least the part of it in which they primarily operate, is moving ahead.

## **CREDIT IS MORE LIKELY TO BE AVAILABLE TO WELL-MANAGED BUSINESSES THAT PRESENT THEIR CASE WELL**

There are mixed views on the proportion of SMEs that are having difficulty raising finances. The level of difficulty depends partly on the type

of finance being sought, the SMEs' perceived viability and their sector, with construction and property suffering most.

Well-managed, viable, businesses with good track records have been able to obtain the finance they require without significant difficulty, especially where they have approached banks with well-packaged proposals.

## **BUT BANK CREDIT NOW COMES WITH TOUGHER CONDITIONS ATTACHED**

Banks are much more hard line now than pre-recession when it comes to lending, with tougher T&Cs and criteria to meet, with increased requirements for security and personal guarantees.

Some feel that the banks have, collectively, been too demanding in looking to maximise fees and margins during a difficult period.

Were it not for historically low base rates, the situation would be even worse, and the fear of base rates rising is lurking in the background.

## **LIMITED COMPETITION IN THE BANK LENDING MARKET FOR SMES**

There is generally felt to be a lack of competition in lending options for the SME market and little evidence of policy differences among or within the banks, but conditions imposed can vary significantly.

## **ALTERNATIVE SOURCES OF FINANCE ARE NOT ALWAYS CLEAR**

Across the SME sector there has been a move away from loans and overdrafts towards asset-based finance like invoice discounting and factoring that has mainly been driven by the banks. However, some SMEs are hesitant due to the cost and because at the same time they are trying to reduce the amount they have tied up in finance.

Banks are seen on the whole to direct SMEs towards other bank products, rarely advising on alternative sources of finance such as finance brokers.

## **NEED FOR MORE TRANSPARENCY AND CONSISTENCY ON BANKS' LENDING CRITERIA AND DECISIONS**

Transparency is felt to vary from bank to bank. Banks could help by being more proactive in setting out their criteria, being less prone to frequently changing these criteria and providing information where a specific loan is turned down.

## **THE RELATIONSHIP BETWEEN BANKS AND SMES IS BREAKING DOWN**

Whatever trust existed between banks and SMEs in 2009 has mainly dissipated, due to the ways SMEs have been treated by banks in the last 9 to 12 months.

Relationships between SMEs and banks are at a low ebb, with some left feeling bruised and scarred about how they have been treated.

SMEs miss the flexibility and helpfulness in their bank's approach that they had become used to before the recession.

## **RELATIONSHIP MANAGERS ARE GENERALLY SEEN AS DISEMPOWERED**

This poor relationship is exacerbated by a perceived continued loss of power of a business's traditional ally, the relationship manager (RM).

The RM's understanding and judgement has been superseded in many cases by 'tick-box' decision making at bank head offices, who are seen as frequently overriding the RM's recommendations.

## **CURRENT GOVERNMENT-SPONSORED FUNDING SCHEMES LESS IMPACTFUL THAN TAX CONCESSIONS**

Government-sponsored funding schemes are recognised as well intentioned, but are felt to be too complex, too little publicised and not attractive enough.

The HMRC tax deferral scheme has been well received by almost everybody, but the constant refrain for how government can best help SMEs going forward is for tax changes relating to corporation tax, Capital Gains Tax, and tax credits.

# ICAEW POLICY RECOMMENDATIONS

Our research suggests that SMEs have adjusted to the uncertain economic environment by showing their resourcefulness and resilience. At the same time relationships between individual banks and their SME clients are breaking down. When the UK recovery is fully established businesses will require finance for working capital and investment to sustain economic growth. Individual banks will need to start rebuilding those relationships now to give SMEs confidence to seek finance for growth.

The following ICAEW policy recommendations are based on the Ipsos Mori research, ICAEW expertise and feedback from our membership to regional staff. While these recommendations require the banking sector to take a lead, it is critical that government, the banking industry, business groups, SMEs and the accounting profession work together to help resolve these issues in the months ahead.

## 1. IMPROVE THE RELATIONSHIP BETWEEN SMES AND THE BANKS

ICAEW believes that the banks need to improve their relationships with SMEs. Businesses miss the flexibility and helpfulness in their banks' approach. The following measures should help restore this.

- The Relationship Manager (RM) should be 'empowered' with greater authority to agree credit applications at local level. 'Empowering' local management will help prevent inconsistencies and delays in the application process.
- SMEs need to have confidence that their RM is their 'advocate' within the bank when presenting credit applications to local and higher management. There will always be some applications for finance when credit decisions have to be referred to a higher level or to a risk committee, but where this is the case businesses need to be confident that the RM is committed to a positive presentation of the business' case within the bank.
- RMs need to have a deeper relationship with their customers to better understand the businesses within their portfolio. This could be helped by RMs having fewer businesses to manage. Increased interaction between RMs and their customers can only improve trust and cooperation.
- Banks need to make a greater effort in facilitating contact between key local bank personnel and businesses so that if the RM moves on the business does not have to start from scratch. ICAEW members claim that their bank RM is regularly changed and does not have enough time to take a detailed interest in the business. Routine invitations to businesses to 'meet your bank team' days could also contribute to improved relationships.
- Banks should also do more signposting to other sources of advice including accountants and government-endorsed mentoring schemes.



## 2. THE PROCESS OF APPLYING FOR FINANCE NEEDS GREATER CLARITY

ICAEW believes that the process of accessing finance should be predictable and transparent.

- The process of applying for finance needs greater clarity. ICAEW wants banks to commit to a 28 day turnaround for 95% of finance applications. The clock would start when the bank acknowledges that it has all the necessary paperwork to process an application. At that stage the bank should also set out the steps in its decision process, including where within the bank the application has to be considered. During the first week the bank will have the opportunity to clarify any points in the application. The bank would be committed to issuing a written response by day 28 in 95% of cases. An offer of a loan would need to set out all the relevant terms and conditions.
- Rejections should be accompanied by advice on whether the SME would be successful with alternative forms of finance and if so which ones (and some indications on from whom). There needs to be a clear appeals process for those businesses that wish to take rejection to a higher level within the bank.

## 3. SMES NEED TO DISPLAY GOOD FINANCIAL MANAGEMENT

- Our research suggests well-managed, viable businesses with good track records have been able to obtain the finance they require, albeit at greater cost and with tougher conditions. Particular difficulties when accessing finance have been experienced by those in certain sectors such as construction and property and some smaller businesses. Businesses need to ensure that their financial management is professional and gives key stakeholders confidence they can meet future financial obligations.
- ICAEW welcomes the British Bankers Association (BBA) commitment to supporting a network of business mentors to help businesses seeking strategic mentoring or coaching.
- Accountants can also ensure the business' financial management meets the needs of the business.

Apart from helping SMEs to access finance, accountants can ensure that there are adequate systems in place to enable SMEs to control cash flow and to be confident in their dealings with finance providers. Businesses offering credit to customers need to maintain up-to-date cash flow forecasts so that they can meet liabilities for payroll, supplies, overheads and taxes as they fall due. Larger SMEs might need to produce monthly management accounts for internal purposes or to assure external finance providers that the business is sound and achieving its objectives. If the business does not have a qualified finance director, accountants can help put these systems in place.

Some four years ago ICAEW (and ACCA) established at the then-government's behest the SME Funding Adviser scheme. The Government was concerned to ensure that SMEs received independent advice on business finance. The scheme identifies firms which offer advice on business finance. This information is available on ICAEW's website at [icaew.com/SMEFinance](https://www.icaew.com/SMEFinance)

## 4. REGULAR DATA ON THE SUPPLY AND DEMAND FOR SME FINANCES

- Greater transparency is essential to assess the demand and flow of business finance. Independent research on access to finance is essential to improve the debate on the state of the economy. The BBA report (see page 8) recommends an independent survey to a methodology agreed with government and business groups. It is essential that this is implemented urgently with the outline of the report being proposed immediately.
- The Bank of England should also contribute to this independent survey and, with its network of regional agents, be central to dissemination of its findings.

# BRITISH BANKERS ASSOCIATION (BBA) REPORT 'SUPPORTING UK BUSINESS'

In October 2010 the BBA published a report of its Business Finance Taskforce entitled *Supporting UK business*. The report, signed by the chief executive officers of the UK's six major banks and the BBA CEO Angela Knight, made 17 recommendations representing 'a far-reaching set of activities, which are intended to be helpful to British businesses' and 'to make a positive difference to the prospects of the UK economy over the coming years' (see appendix).

ICAEW welcomes the BBA report and recognises that the BBA has a considerable task in achieving every recommendation. ICAEW believes that implementation of these recommendations is critical and will cooperate fully with the BBA to ensure they are implemented in a timely manner.

ICAEW believes that the following recommendations in particular are central to the BBA's vision for improved access to finance for SMEs. (The numbers in brackets refer to the BBAs numbered recommendations, listed in the appendix).

## IMPROVE CUSTOMER RELATIONS

- Improve service levels to micro enterprises by setting out a new Lending Code (2).
- Publishing lending principles that set out the minimum standards medium and larger businesses can expect (3).
- Establish a transparent appeals process (4).
- Initiate a pre re-financing dialogue 12 months ahead of term loan coming to an end (5).

## ENSURE BETTER ACCESS TO FINANCE

- Signpost alternative sources of finance (10).

## TO PROVIDE BETTER INFORMATION AND PROMOTE UNDERSTANDING

- Fund and publish a regular independent survey so that there is an agreed and authoritative set of data on business finance demand and lending supply (12).
- Improve customer information so customers can understand what products will best meet their needs (15).

Many of these recommendations will still require the BBA's involvement and direction. Nowhere is this more important than in delivering transparency through an independent survey of SME finance.

The implementation of the BBA's recommendations by individual banks will be essential in improving business bank relationships. ICAEW also believes that the banks should adopt the ICAEW recommendations.

# MAIN FINDINGS: SME ACCOUNTANCY PARTNERS

## SMES ADAPT TO THE NEW REALITY AND FOCUS ON THE FUNDAMENTALS

On the whole SMEs are perceived to be managed better than they were in the last recession.

The last 9 to 12 months have demonstrated the essential resilience of those small and medium sized enterprises that have survived the earlier stages of the recession.

Businesses that took the necessary action when faced with dramatic reductions in turnover, especially early on, are now coping fairly well and have adapted to the situation. Those that were historically managed better were able to adapt more quickly. But some businesses have struggled and been forced to face defeat, particularly in property and retail.

With the future economic environment still unsettled, many SMEs are weathering the storm by re-focussing on cost, cash and debt management.<sup>1</sup>

“ I think through strong cost-cutting measures probably when the credit crunch first hit and the recession first started to bite, and took reasonable steps to survive.  
**Six Largest**

“ There’s quite a few out there who didn’t want to see the signs and therefore left it too late before they started planning any cutbacks to do their cost reduction plans. Those who were on top of things were able to make the necessary adjustments and be flexible in terms of where their markets are.  
**APA**

## DEMAND FOR CREDIT LOW AS SMES WAIT FOR SIGNS OF RECOVERY

Demand for debt finance remains flat with many SME businesses attempting to reduce their reliance on bank finances. They are trying to cope with the facilities they already have, reorganising their finances (cash flow, cost and debt management) and re-structuring these where necessary. There is also plenty of evidence of plans for capital projects and expenditure being put on hold or cut back. Some SMEs are also raising finance by selling assets or by shareholders or directors putting money into the business.

Others are trying to repay capital while interest rates are low.

It is very much a defensive approach, focusing on the fundamentals, biding their time and waiting for signs of recovery.

“ ‘Cash is king’, just focused on that really... looking at the bigger picture and saying, ‘how can I work my cash better, get debtors in quicker, can I stretch out a few creditors, can I tweak a margin here or there and so on, just to get more cash out of what I do’.  
**APA**

“ [some have the view that] ‘We’ll just live with what we’ve generally got’ and they won’t want to run the risk that if something does happen to the business and all of a sudden they lose 10% or 15% of their turnover, they don’t want to be in a position where the banks have got the upper hand.  
**Six Largest**

1. Where quotes are drawn from interviews we have indicated the group to which a firm belongs

Against this low level of demand, with many SMEs 'treading water', the supply of finance over the last 9 to 12 months is considered to have been adequate.

Most feel the picture remains difficult to read in the current economic climate. No dramatic changes in demand for finance are expected in the next few months. This is particularly the case when it comes to demand for new money, and there is minimal merger and acquisition activity on the horizon.

“ If you talk to anybody in M&A other than a very high level, there's just not a lot going on at the moment.

**UK200 Group**

The effects of the recent Comprehensive Spending Review add further to the uncertainty over the future levels of demand and business confidence among SMEs, especially those directly exposed to the public sector.

A few mention that the VAT increase in the New Year could trigger some growth in the demand for credit.

“ It [the CSR] will hurt and obviously those who for example are very dedicated to one particular government department or whether they're into a local authority supplying paper or they're into supplying into the health service or they're into supplying MoD. The question is, how far back down the food chain from those people having an immediate interface, how many of those are going to be affected.

**Six Largest**

“ If they [public sector] were able to move more of its contracts into the private then it might stimulate some growth in the SME market.

**Six Largest**

Further ahead, a gradual increase in demand is likely to be sector specific and will depend not only on the UK but the global economy, due to the importance of exports to the recovery.

“ ...media is undoubtedly showing a pick-up as is technology and we're certainly seeing a growth level of confidence in terms of those sectors, because corporates are turning back on spend, there's a limit to how long you can actually turn off some spend.

**Six Largest**

“ I think there are companies that are growing and are looking for finance where they've got great products in growth markets or they are exporting well.

**Six Largest**

“ I'm certainly not an economist but the problem we seem to have is we don't export a lot of things and the things that we do export are generally maybe to Europe and America where they're struggling the same way we are. We don't seem to export to countries like China and India where they're going through very good times.

**UK200 Group**

## **CREDIT IS MORE LIKELY TO BE AVAILABLE TO WELL MANAGED BUSINESSES THAT PRESENT THEIR CASE WELL**

There are mixed views on the proportion of SMEs that are having difficulty raising finances. The level of difficulty depends partly on the type of finance being sought, the SMEs' perceived viability and their sector.

“ 60%-70% are going to have difficulty because they're not viable, and banks won't lend because the directors/shareholders have taken too much money out or they've got tax bills to pay that they didn't plan for. The banks aren't going to lend for that. So they say, 'You sort it out'. They're not going to fund a problem.

**UK200 Group**

“ Viable means, because we're always asked this question – 'How good is the management team, is it a balanced team, is it a positive-thinking team, is it a flexible, intelligent management team?' And it's about having a particular product and a service to offer that's likely to have some demand going forward.

**Six Largest**

“ I'd say about 25% are having difficulty in getting finance. You can normally get it, I think if you're a well-run company but you've got to pay a high price for it.

**APA**

“ I think the criteria in going through credit at the moment seem to be extremely tough; you need to go through many more hoops than you did before and I think a lot of businesses are getting turned down flat because maybe they’re in the wrong industry or the wrong sector.

**APA**

Well-managed, viable, businesses with good track records have been able to obtain the finance they require smoothly and without significant difficulty, especially where they have approached banks with well-packaged proposals.

“ I think for a well-run and well managed business, and they’ve got a good track record, then the facilities have generally been there.

**Largest Six**

“ If you’ve got a good track record and you see your manager regularly; you send in financials and your financials are up to date, then it certainly helps.

**UK200 Group**

“ If you’re a good business then I think it’s relatively easy to increase your facilities. I think if you’ve got an existing relationship, then I think the banks have been reasonably supportive, but I think if you’re trying to shift from one bank to another bank, unless you’ve got a very good business, very profitable and very cash-generative then generally speaking the banks have shut up shop.

**Six Largest**

Accountants mainly see their role as helping SMEs present themselves as well as possible to the banks when applying for finance. They also know which institutions are currently lending and can point SMEs in the right direction. A minority also feel they can offer management advice, helping to address fundamental business problems and get businesses better prepared before they approach banks for finance.

“ [Accountants can help by] making sure the banks understand the business, and equally not putting stupid propositions to the banks. In other words, telling a client to go away and get the business right and then come back in six months time. Because a) you’ll get more and b) you’ll probably get it cheaper.

**UK200 Group**

“ We can act as a sounding board to propositions, so we understand probably better than the SMEs what sort of structures will work for a bank and what won’t. We can help in terms of addressing the more fundamental problems within a business to say that, ‘OK you need this funding, we can help talk to the banks but actually what we ought to be looking at as well, is how we improve the quality of the business and its attractiveness to a bank’.

**Six Largest**

“ If I have a difficult proposition to put to the bank, I’ll say to client, I want to be there because I want to make sure the manager asks you all the right questions. What we don’t want, it going to credit and if he does not understand it, and the credit pull it apart, then you’ve lost.

**UK200 Group**

## **BUT BANK CREDIT NOW COMES WITH TOUGHER CONDITIONS ATTACHED**

Banks are much more hard line now than pre-recession when it comes to lending, with tougher T&Cs and criteria to meet, and increased requirements for security and personal guarantees. This greater requirement for guarantees is most notable in relation to start-ups where finance has been less forthcoming and personal liability is now sought by suppliers.

“ It’s a lot more personal security, a lot more charges over property etc. The actual bank charges for arranging the finance I think have gone up and are less negotiable; there used to be a time where they’d say - we’re going to charge you an arrangement fee of 2% - and you could negotiate that down to 1%, now that’s not negotiable anymore.

**APA**

“ We are seeing the banks taking a much tougher line in terms of personal guarantees and so on than they used to, in order to improve their security. And there are a lot of people who are reluctant to give personal guarantees because basically it frustrates the whole idea of having a limited liability company and those ones are just battenning down the hatches and carrying on as best they can within the facilities they’ve got.

**UK200 Group**

Some feel that the banks have, collectively, been too demanding in looking to maximise fees and margins during a difficult period, especially as SMEs find it difficult to re-finance elsewhere.

Despite current low interest rates, the fees, charges and margins banks are requiring have gone up since the start of the recession, all of which are another concern for SMEs needing to borrow. At the moment, the low interest rates make this less painful than it might otherwise be.

Many would like to see banks demonstrating more flexibility in their dealings with SMEs when it comes to loan applications. While it is accepted that there is a limit to what banks can do, they should not be seen as setting unreasonable terms that put an excessive strain on business's finances in the recession.

“ I mean one of our clients just wanted to borrow £1,000 or something and the bank said the minimum arrangement fee on that would be £500. So £500 doesn't sound a lot but when this client only wanted £1,000 it's significant. So that put the client off altogether wanting that money.

**UK200 Group**

“ If interest rates hadn't been so low, certainly if the bank base rate hadn't been so low then I think it would've been extremely hard for them. The fact is that we're operating in a very low interest environment and therefore to some extent the banks charging their high margin can just about be absorbed, so I think that's the only saving grace, but obviously if interest rates had been 2½% - 4½% higher and the margin that'd come on top, I think we would've seen a very, very different economy landscape. So that is the only saving grace why the businesses have been able to reluctantly absorb that cost.

**UK200 Group**

Accountants believe that banks sometimes over-state their willingness to lend:

“ Publicly xxx are lending, but actually they're not interested.

**Six Largest**

## **LIMITED COMPETITION IN THE BANK LENDING MARKET FOR SMES**

There is generally felt to be a lack of competition in lending options for the SME market, unlike the situation for large corporate lending.

“ If I were the government I would be most concerned about the competition in the business banking sector and RBS flogging off a few branches is not going to solve that problem, and there are alternative sources of financing which are available just now potentially for the upper end of the SME sector, which are being squeezed out by the banks and really I think the government should be looking at the competitive position but also they should be looking at promoting alternative sources of finance for the SME sector.

**Six Largest**

“ I would've thought the biggest impact would be having another strong competitor in the market who actively wants to put money to work, and could help with both of ability and pricing.

**Six Largest**

There is little evidence of policy differences among or within the banks, but conditions imposed can vary significantly. While there is understanding of the banks' predicament in trying to strengthen their capital ratios, many feel the banks are making an excessive profit in the current environment, at the expense of their business customers. No banks are spared from this criticism, though there is recognition that circumstances can differ within banks.

“ I think the banks are being quite opportunistic and are trying to maximise what they can get out of situations, so these charges and margins etc. are pretty consistent I think in the marketplace.

**Six Largest**

## **ALTERNATIVE SOURCES OF FINANCE ARE NOT ALWAYS CLEAR**

Banks are seen on the whole to direct SMEs towards different forms of bank finance they offer. They are perceived to be more concerned about what type of lending will be best for them, the banks themselves.

There has been a move away from loans and overdrafts towards asset-based finance like invoice discounting and factoring that has mainly been driven by the banks. However, some SMEs are hesitant due to the cost and because at the same time they are trying to reduce the amount they have tied up in finance.



Nearly all respondents report that banks rarely advise on alternative sources of finance (eg, finance brokers), or only to a very limited extent when they turn down a loan application.

“ Well they say they help access appropriate forms of finance. But they don’t do anything that isn’t going to benefit them, do they.  
**UK200 Group**

“ People are looking at alternative sources and anyway obviously the changes in legislation some time ago have meant that many people have not been able to access an overdraft in the usual way or a loan, and they’ve been forced to go down confidential invoice discounting or factoring because of the security that the banks would take.  
**Six Largest**

“ I have clients that have invoice discounting and factoring that wouldn’t be here today without it.  
**UK200 Group**

Equity finance is a suitable alternative in some situations although it is in short supply, particularly at the smaller end of the SME sector. At the same time, there is not a great deal of demand. On the whole, SMEs tend to want to avoid giving up equity in their business, but some smaller, long-standing SMEs now have to consider relinquishing equity due to the economic climate.

“ ...[it] is sad in a way sometimes, that they might have run this company for 30 years so all of a sudden they’re giving away 40% of it for a relatively small amount of money. That’s not massively common but I’ve seen it more in the last 9-12 months than I have for a long time.  
**APA**

## **NEED FOR MORE TRANSPARENCY AND CONSISTENCY ON BANKS’ LENDING CRITERIA AND DECISIONS**

Views on the consistency and transparency of bank lending policies and criteria are mixed. Some see banks doing as much as they can or should do. Others feel banks should do more and be more predictable and transparent in their lending decisions.

Transparency is felt to vary from bank to bank. Moreover the banks’ credit committees’ criteria can frequently change which makes it difficult to arrange finance.

“ I don’t think they’re particularly transparent, I mean I’ve probably a greater understanding than the SMEs and I can follow it and I know why they’re doing things, but if I don’t get involved in the negotiations at all then I do feel sorry a little bit for some of the SMEs, because they can quite easily be led down a path which might not be appropriate.  
**APA**

“ They are a bit inconsistent.  
**UK200 Group**

“ Across the banks there are incredible inconsistencies and I think many of the frustrations were caused by that, and by the atmosphere, understanding what the new rules were and certainly the time it was taking in making decisions was very, very frustrating and damaging.  
**UK200 Group**

“ I would say they are pretty transparent. You know what you’re going to have to pay before you sign up.  
**Six Largest**

The banks could help by being more proactive in informing SMEs about what they need to do before asking for finances.

“ Although they’re quite clear on their decisions and why they’ve decided on whatever they have on a funding decision, I think they probably need to be a little bit more active in telling businesses what’s going to be required before they go. I mean we do it as accountants, what you’re going to need to have in place before you go to the bank or when you set up a business, but I think maybe the banks need to be a little bit more proactive in that.  
**Non-attributable**

The reasons for refusal of finance are rarely given, and a minority feel it would be helpful if banks gave more information and guidance about why they turned down specific loans.

SMEs have little knowledge of the appeal process. It was felt that pursuing the appeals process would not make any difference and be unlikely to achieve anything worthwhile. The few with experience of appeal process still got the same reasons for which the finance was originally turned down eg, no account with the bank, not enough sector experience, etc.

“ I’ve not used the appeals process and I wouldn’t even know clients would be aware that there’s an appeals process to go down.  
**UK200 Group**

“ I haven’t come across anybody; I’m not even aware that they know and certainly we don’t go and advise it, not as a matter of policy.  
**Six Largest**

“ Personally I’ve not known any that have used that process. I mean I would question whether many clients even know that there is an appeal process.  
**UK200 Group**

## THE RELATIONSHIP BETWEEN BANKS AND SMES IS BREAKING DOWN

The majority feel that whatever trust existed between banks and SMEs in 2009 has mainly dissipated, due to the ways SMEs have been treated by banks in the last 9 to 12 months, in particular when seeking finances. Most feel that there is currently no real ‘relationship’ between the banks and their SME clients. Any relationship, such as it is, is mainly seen as weak or poor and certainly worse than it was before the credit crunch.

“ SMEs are still quite bruised by the way they have been treated by their banks.  
**Six Largest**

“ [the SME/bank relationship] has been damaged beyond all recognition over the last 12-18 months.  
**UK200 Group**

“ Certainly with my clients I think as soon as the opportunity arises they will re-finance with a different bank, albeit that they do realise that probably all the banks have been very similar in terms of charges and margins and things like that. They just don’t like the way that the banks have played a really heavy-handed approach to them.  
**Six Largest**

“ I think that bankers will never be held in the same revered position that they used to be; I think there’s a very, very cynical feeling about how banks and bankers have behaved; respect has been lost massively.  
**UK200 Group**

“ I would say that it’s probably at its weakest... Over time banks have just been wanting to sell and that’s what they’ve become now, is a commodity – they sell finance and ancillary products; they don’t lend anything to the business process.  
**UK200 Group**

A minority comment that some SMEs don’t help the situation through the way that they present themselves to the banks.

“ It comes a lot back down to the quality of management. I think if you manage your bank on the basis of no surprises, no kind of closure, you can maintain a pretty constructive relationship. Where we’ve seen relationships break down is where there hasn’t been transparency, where businesses have changed but they haven’t invited the bank in to actually tell them all about their business as it is now, what’s changed, what’s different and what are they focusing on.  
**Six Largest**

## RELATIONSHIP MANAGERS ARE GENERALLY SEEN AS DISEMPOWERED

The relationship breakdown between SMEs and banks has been made worse by the perceived continuing loss of power of the RMs. Some still mention occasions in 2010 where the RM has been highly positive in terms of the likelihood for finance to be agreed, only for this to later be turned down by the credit committee.

“ It’s difficult to arrange from jumping over the first hurdle with the bank manager maybe to getting all the way to credit and getting it refused – that’s been one of the most common things and I sort of feel sorry for the guys on the ground, the relationship managers at the banks, because they’re working the way they used to work, what to them is a good deal and put in a proposal and send it up to credit, and all the signs look good and then credit turn around and say no, sometimes what appears to be, from our perception, very little reason really.  
**APA**

Many see the RM’s position undermined or left unsupported by their head office, while some go even further and view their role as disempowered and reduced to being a gatekeeper and fact-checker. Even when RMs are felt to be understanding and seen to be arguing the SMEs’ case, committees, credit teams or tick-box decision making are limiting their ability to lend. Furthermore, this is causing decisions to be delayed and to be perceived as inconsistent.



“ Most people would say that the relationship manager generally is probably just a fact-gatherer at the moment; he’s not really a relationship manager at all; he’s just pulling together some information to go to credit and it’s the credit committee that probably makes the decisions.

**Six Largest**

“ I think in most cases they [the local managers] are as supportive as they’re allowed to be, but at the end of the day they are dictated to from above.

**UK200 Group**

“ They [RMs] can’t do as much on their own authority as they used to do, because all of the banks have beefed up their risk management as you would and that means that there is more stuff that’s getting overruled; they aren’t empowered to lend on a whim and judgement the way that they use to. It’s all much more clinical now, which some would say is good.

**UK200 Group**

“ There is no flexibility these days; the days of an old-fashioned bank manager who understood their client and could understand the particular difficulties seem to have gone because it would seem that the rules governing the bankers are such that, if certain criteria aren’t met then that’s the end of the story.

**APA**

“ They [the banks] need to listen more and understand the business more. They need to have more experienced people and not just box-tickers.

**APA**

A few mention that local staff changes are further undermining the relationship between SMEs and RMs.

“ Locally we’ve found that there are a lot of changes in the corporate bank managers. So the relationships have suffered because there’s been a lot of change in personnel from the banks.

**UK200 Group**

“ I’ve seen so much transition and movement within that industry in the last few years, and people jumping ship. And part of it I think is that power has been taken away from them really.

**APA**

A minority remain positive about their RMs. In those cases RMs are seen to be proactive, to have a good understanding of SMEs and are best placed to argue their clients case with head office or the credit committee.

“ It very much depends on the relationship manager actually, not necessarily the bank itself. It comes down to the person, are they doing it just as a job or do they enjoy it, get stuck in and enjoy the customers really. I think it’s very easy to see who does that, because if somebody’s in some financial need, they will sit down and think about what’s best for their particular situation; others – there’s lots of examples where I think they’ve just said - right let’s just throw this in, it might be a nice chunk of money but inappropriate finance for the balance sheet.

**APA**

“ I think what the last 9-12 months has done has shown people who are the good managers and who are the less good managers. I think the good managers have been a lot more proactive with their clients, sitting down with them at an earlier stage and talking about their financial need.

**UK200 Group**

## **CURRENT GOVERNMENT-SPONSORED FUNDING SCHEMES LESS IMPACTFUL THAN TAX CONCESSIONS**

The majority are critical of the various government funding schemes that exist due to how long they operate for (ie, being short-term only), restrictions on the loans, criteria used (eg, that a loan must still be supported by a bank) and the complexity involved in applying for funds.

Some accountants and the SMEs they deal with do not have much knowledge or experience with these schemes.

“ I think the government have been well-intentioned with those schemes that they’ve put in place, but as often is the case with these large and grandiose schemes, the process behind it has made it overly complex and by the time an entrepreneur has worked their way through the forms and the whole process, either it’s too late or actually they’ve found an alternative. They’ve just over-complicated it.

**UK200 Group**

“ The general feeling is locally that there’s not been that many instances where the loan guarantee schemes have been used.  
**UK200 Group**

“ They set up the Enterprise Finance Guarantee (EFG) scheme but that hasn’t really helped because the banks are using their normal criteria to say yes or no.  
**APA**

Some see a greater need for more targeted funding schemes (eg, for certain sectors).

Awareness of the BBA Business Growth Fund, announced while the interviews were conducted, was patchy, and the general view was that the money was aimed at businesses larger than the typical SME.

The best way for the Government to help SMEs is perceived to be through various tax breaks and concessions relating to corporation tax, Capital Gains Tax, and tax credits that encourage investment in various sectors such as manufacturing.

“ You’ve got to think about entrepreneurs and you’ve got to think about those people who are taking risks and who are building and creating businesses, or driving forward existing businesses. I think what you’ve got to look at is how you incentivise them in relation to their ownership.  
**Six Largest**

“ I would give more money through R&D tax credit systems to any business that is trying to resolve technical uncertainty.  
**UK200 Group**

Views on the HMRC’s tax concession are almost unanimously positive, ranging from those that see it as very positive ‘a lifesaver’ and those that are positive but balanced this with comments that it is only a deferment of payment. Nobody criticised this concession, but a few point out that it will only go on for a limited period.

“ We saw that early on and quite a few clients took advantage of that, in helping them downsize, but... I think the general view is that, unless it’s exceptional circumstances, the Revenue are probably maybe more hard-line now.  
**Six Largest**

“ That has been a real tangible benefit... But of course once you’ve had one deferred payment, when it comes round to pay the next instalment they’re not keen for you to do that, so it was a one-off when clearly it needs a longer term.  
**UK200 Group**

When it comes to other ways that the Government can support SMEs, there are some concerns about possible rises in interest rates and the effect on lending. With such a low base rate SMEs can still cope with the cost of loans despite the additional charges banks levy on top of the base rate. However, loan costs could become a greater problem if the base rate rises and the banks do not reduce their charges, especially where SMEs are just surviving under current conditions rather than thriving.

“ I think the steps the government took then and remain in place, particularly as regards low interest has undoubtedly helped businesses.  
**Six Largest**

“ I guess holding interest rates at 0.5%, that would be helpful. I think capping the rates that a bank could charge over either LIBOR or base rate would also be helpful.  
**UK200 Group**

# THE SITUATION VARIES BY SECTOR AND SME SIZE, BUT LOAN DECISIONS TEND TO BE MORE INFLUENCED BY SECTOR THAN BUSINESS SIZE

## SOME SECTORS REMAIN A CONCERN...

Banks are generally reported as being less willing to support some sectors, especially property and construction companies.

Also, to some extent retailers, hotels, and leisure due to their reliance on consumers' discretionary spending.

“ Property clearly is a very inflamed and difficult sector...The other sectors currently needing considerable attention are pubs and clubs, and hotels. Construction has sort of been in a fairly stable state of decline for a while.  
**Six Largest**

“ Property has almost been cut off really by some banks.  
**APA**

“ Retail has been a struggle as well.  
**UK200 Group**

Sectors reported as doing better and being treated more favourably by some banks include technology and, to some extent, manufacturing. Cutting edge businesses in new technologies are also more attractive for investors when it comes to equity finances.

“ Anything to do with healthcare, IT, technology and online businesses, and the environment. Their track record tends to be more positive at the moment. If you've got a current track record of high performance it might make the banks feel a bit more positive about lending.  
**UK200 Group**

## LARGER SMES TEND TO BE FAVOURED...

There are some signs that banks are more likely to lend to larger SMEs which are seen as more stable and less of a risk than smaller SMEs. Larger SMEs tend to have bigger management teams, are also more likely to provide more frequent and better prepared management information which helps to reassure banks, and there are less likely to be any unpleasant surprises.

“ In some ways banks are very keen on larger businesses because they're just perceived to be more robust and reliable and actually less costly for them to do business with. So perversely the pricing for loans is a lot pricier for SMEs.  
**Six Largest**

“ ... at the smaller end of SMEs (the ones below £34m turnover), they won't even get a business manager allocated now and it's very difficult for them to get advice from the banks.  
**UK200 Group**

The situation for smaller SMEs is further compounded by poor availability of alternatives, such as equity finance, for these firms, albeit that their demand for this is relatively low.

# APPENDIX

## BRITISH BANKERS ASSOCIATION *SUPPORTING UK BUSINESS* REPORT RECOMMENDATIONS

### TO IMPROVE CUSTOMER RELATIONSHIPS WE WILL:

1. **Support a network of business mentors** by working with the business groups to deliver this free service to small businesses across the UK.
2. **Improve service levels to micro enterprises** (businesses with fewer than 10 employees and turnover or a balance sheet under €2m) by setting out in a new Lending Code the levels of service banks will provide and outlining additional sources of help and advice.
3. **Publish lending principles** which clearly set out the minimum standards medium-sized and larger businesses can expect when asking banks for loans and other services.
4. **Establish transparent appeals processes** for when loan applications are declined, with processes independently monitored by a senior independent reviewer, who will publish the results of their review, to ensure each bank has a fair and equitable appeals process.
5. **Initiate a pre re-financing dialogue 12 months' ahead of any term loan coming to an end**, which will include a timely review of business and refinancing needs and an assessment of what needs to be in place ahead of loan expiry to maximise the prospect of successful re-financing.

### TO ENSURE BETTER ACCESS TO FINANCE WE WILL:

6. **Establish and invest in a new £1.5 billion Business Growth Fund** (built over a number of years) to fill a crucial gap in the market and provide capital for viable businesses which want to invest and grow.
7. **Support the Enterprise Finance Guarantee Scheme**, seeking continued Government backing through to 2012, and accommodating any changes made by Government.
8. **Help mid-sized businesses access syndicated debt markets** by raising customer awareness, training customer-facing staff and engaging more actively with business groups and customers.
9. **Improve access to trade finance** through targeted SME awareness-raising campaigns and exploring possible regulatory adjustments with the FSA. Seek to open with Government access to trade finance products for businesses that qualify for the Enterprise Finance Guarantee Scheme.
10. **Signpost alternative sources of finance**, giving customers helpful information and advice if a loan is declined and raising awareness about the financial solutions they should consider.
11. **Help improve the supply of credit to the wider economy**, working with the authorities to ensure that wholesale markets can support the necessary lending capacity as the economy recovers.

## TO PROVIDE BETTER INFORMATION AND PROMOTE UNDERSTANDING WE WILL:

12. **Fund and publish a regular independent survey**, commencing in early 2011, to a methodology agreed with Government and business groups, so there is an agreed and authoritative set of data on business finance demand and lending supply.

13. **Enhance the cross-industry lending dataset** by broadening the statistics on lending available for wider bands of business activity; on lending to deprived areas; and on national and regional data on the provision of bank support to business start-ups.

14. **Hold regional outreach events** throughout 2011 with business groups to enable business customers and business groups to meet with key staff from the banks to answer questions and explain what services are available.

15. **Improve customer information** including a review of literature and other materials, so customers can more easily understand what products will best meet their needs.

16. **Host a dedicated website** through the BBA to draw together and link useful sources of information to help customers access the most appropriate information. This will also connect mentoring networks.

17. **Establish a Business Finance Round Table** where senior representatives from the banks and business groups meet regularly to discuss and review trends, identify emerging areas of concern, ensure problems are addressed and facilitate the implementation of the Taskforce initiatives.

# TECHNICAL DETAILS AND ACKNOWLEDGMENTS

## TECHNICAL DETAILS

Interviewing was conducted by telephone between 12 October and 9 November 2010, among accountancy firms' partners responsible for SMEs. All respondents were screened to ensure they dealt with UK SMEs (defined as businesses having fewer than 250 employees) across a variety of sectors and regions on a regular basis. Twenty-one respondents were asked open-ended questions about the various issues involved in SMEs obtaining bank finance.

Equal numbers of interviews were conducted within each of the following groups of accountancy firms:

- Six largest UK network firms
- APA (the Association of Practising Accountants)
- UK200 Group

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