

GETTING THE BEST FROM YOUR BANK

THE BANKS BELIEVE THAT THEIR CREDIT POLICIES ARE CONSISTENT – THERE ARE JUST MORE HIGH-RISK BUSINESSES AROUND THESE DAYS. **CLIVE LEWIS** REPORTS



At a recent meeting of bankers and small businesses organised by the Department of Business Innovation and Skills (BIS), there was general agreement that demand for finance was down in 2009 over 2008. However, rejection rates for overdrafts (but not term loans) were up, with one in three applications for overdrafts by 'high-risk' businesses rejected.

But some corporate finance advisers are saying that banks are chasing the most secure, promising businesses, and these businesses are quick to deflect to another bank if a better offer is in prospect.

So how can a business ensure it is getting the best deal from its bank? How do you know if your business is 'high-risk' or one of the most secure? When should you consider transferring to another bank?

A CHANGED ENVIRONMENT

First, businesses must recognise that the environment for debt finance has changed. There was general unanimity at the BIS meeting that banks have become more risk-averse as a result of the high impairment charges, and that the costs of accessing finance have risen. The margins on loans and overdrafts have increased, and arrangement fees and the ongoing cost of reviews are higher. As a result of Basel II, the accord on minimum capital requirements (the more risky the business and the longer the term of the loan, the more capital that has to be held), banks are looking more closely at risk and, consequently, security.

From the banks' perspective, they are not more risk-averse. They believe that their credit policy is consistent – they lend through the cycle, but there are more businesses that are in the higher-risk category as a result of the

recession, and more that simply aren't viable.

Interest rates are much lower in real terms for businesses, and while for new borrowing the margin over base might have gone up a little bit, that's more a reflection of the fact that the cost of funds for a bank is much higher than base rate than of any changes to capital requirements.

The 2010 Budget brought commitments from the two state controlled banks to lend a gross total of £94bn in the year ended March 2011. It also promised a new statutory small business credit adjudicator to ensure SMEs are treated fairly when applying to their bank for finance. The adjudicator will be given statutory powers to make its judgments enforceable. If the Labour Party is returned to power after the general election it has stated it will pass the necessary legislation to bring the adjudicator into being.

INFORMATION REQUIREMENTS HAVE INCREASED

Many businesses have also noticed that the banks demand more information, and it is required more frequently. Ian Kay, managing director, regional coverage banking, London, for RBS Natwest, says: 'Banks have learned from their past experience. Greater transparency leads to an open and honest relationship. RBS issued a guide, *Helping Businesses in 2009: A practical guide to cash flow and finances*, which details the information the bank requires from smaller businesses and why it requires it. This improved information means we can understand the business plan, spot trends earlier and are therefore better placed to help and respond.'





RELATIONSHIPS ARE IMPORTANT

Banks also stress the importance of regular dialogue with them, and keeping the relationship manager informed. Because of the increased level of regular information that banks require, it is difficult to keep bad news from them for long. But it is important to give a balanced picture of prospects at all times.

SO IS THE BUSINESS'S RISK PROFILE

Banks use a variety of information to assess the risk associated with business finance facilities. Stephen Pegge, communications director, commercial banking, at the Lloyds Banking Group, says: 'The key must be to make yourself an attractive business – do what you can to manage the risk you present to a lender and communicate your plans and controls well.' He adds: 'For smaller businesses, a key input to most lending decisions is behavioural scoring data (how accounts are run and loans repaid – basically, unauthorised overdrafts, missed payments and dramatically falling turnover are bad) and credit reference data (paying suppliers late, court judgments, late postings of accounts at Companies House).'

Simon Walters, managing director of FD Solutions, puts it this way:

'Provide your banks with timely and accurate information to enable them to assess your current position and to see with clarity what your likely funding requirements will be. Banks don't like surprises; if you've fallen short of your projections in the past, make sure that your FD provides them with sufficient information to show that you have a grip on the finances. Make sure you're complying with all your loan covenants, and in return for making your bank manager's life as easy as possible, make sure you're paying competitive rates. It doesn't do any harm for your bank manager to know that you always want the best deal available, whether it's from him or from somewhere else!'

TRANSFERRING – NOT TO BE UNDERTAKEN LIGHTLY

The evidence provided at the BIS conference suggests that around a quarter of businesses were either fairly dissatisfied or very dissatisfied with the availability of finance from their main bank. Dissatisfaction was even higher on charges. But bank switching rates were generally nothing like as high.

Why is that? If you have been with your current bank for some time, it is difficult to comprehend that a different bank may have a different culture. Figures suggest that more businesses are switching banks but, given the experience of the past two years, that is hardly surprising. To an extent, bank charges have always been a sensitive issue for some businesses. This is particularly true when business owners see the interest rates paid on deposit accounts compared with interest charges on loans and overdrafts. And business owners wonder why personal banking is 'free' when business banking is not. But Pegge says: 'There is a perception thing at play here, but those customers who work with their bank to reduce their costs – say by using electronic forms of payment, which can often now be free – can get their costs down, and that suits the bank, too.'

Who might you turn to if you are considering switching banks? It's always a good idea to talk to corporate finance professionals – they have a good idea of where the market is at and which banks to approach. This is particularly true if you have a new need for finance or have been rejected by your current bank – although you should always discuss rejection at a higher level in your current bank. Some banks have a confidential hotline that you can use to make an initial approach to alternative sources of finance.

If you are considering a new source of finance, it helps to be open to suggestions of alternative types. Businesses like overdrafts because of the flexibility, but invoice finance can give an increased facility. Banks now view overdrafts less favourably because the whole facility, not just that portion utilised and earning interest for the bank, is regarded as the basis for the bank's regulatory capital allocation. In addition, an overdraft can spiral out of control quickly.

Accessing an appropriate amount of finance will be a key requirement for UK businesses as the economic recovery becomes more firmly established and businesses seek to resume their growth trajectory.



IN A NUTSHELL

The environment for accessing finance appears to be improving. Banks say they are 'open for business'.

- Banks are more risk-averse and demand greater visibility of business performance.
- Banks are seeking an open and honest relationship that can help resolve a business's problems.
- Work to understand your business's risk profile and how you might improve it.
- If refused finance, or the terms offered are unacceptable, consider appealing to a higher level in the bank hierarchy.
- Be aware of what other banks might offer.
- Finance is now more expensive in terms of interest margins, arrangement fees and monitoring costs.
- Consider raising more equity finance as an alternative or to supplement debt finance.
- Good financial management should focus on tying up less working capital for any given level of business activity.

Clive Lewis is head of enterprise at the ICAEW