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To Breedon Taskforce

## **Supply chain finance: additional insights**

ICAEW is pleased to provide additional evidence to the industry taskforce led by Tim Breedon in connection with the Taskforce's call for evidence, *Improving Access to Non-Bank Debt*, which closed on 27 January 2012.

The ICAEW Corporate Finance Faculty is a network of some 6,000 corporate finance practitioners, including advisers, accountants, lawyers, financiers and corporate development professionals.

In the context of its thought leadership initiative, Financing Change, the faculty convened a roundtable on 7 February 2012 to understand the challenges faced by supply chains in accessing finance and any implications for the UK's growth agenda. Attendees included representatives from: a leading automotive manufacturer; a substantial international construction company; and a leading telecommunications company with annual supply chain budgets totalling in excess of £6.0 billion.

The issues debated by major businesses and representatives of Tier 2 suppliers, providers of asset-based finance and various trade bodies, yielded the insights and evidence described below.

### **General market failures**

1. There are indications that capital *is* available to lend in forms other than bank loans both to SMEs and larger concerns. Evidence was presented that this is the case, both with non-bank lenders and arms of banking groups, although the former can also face difficulty borrowing as banks consider them to be competitors.
2. Businesses are not sufficiently familiar with non-bank loan options and banking arms are not referring customers to asset-based lenders.
3. Cross guarantees obtained on conventional bank lending can be a barrier to asset-based lending where they are not released in line with exposures.
4. Asset-based lending can only form part of a suite of financing options. For smaller businesses it can be unsuitable due to the product's complexity, the cost of due diligence and resource-intensive reporting and management.
5. Where they are in place, take-up of supply chain programmes can be low, although the main reasons for this are unclear. In other cases the manufacturer/ end buyer may not afford to lose part of its credit capacity to the supply chain, due either to its own working capital needs or limited credit facilities.

**Sector issues**

6. Manufacturers or end buyers are generally prepared to invest in innovation within their supply chains and recognise the need for 'patient capital'. They are not willing to finance working capital requirements other than as lenders of last resort. Some have done so during the downturn.
7. Evidence was provided of finance providers, in particular UK clearing banks, being unable to respond to extraordinary changes in financing needs that arise from step changes in production or significant capital outlays. In certain instances this has resulted in original equipment being sourced from overseas, despite higher cost, arising from higher transport costs.
8. There are structural difficulties with grant funding, including the Regional Growth Fund, that render them less successful in targeting lower tiers in supply chains but also sectors such as OEM. By way of illustration, narrow application windows are difficult for small businesses to operate in. The need to prove capital outlay before grant funding is released presents small businesses with significant working capital problems. It remains to be seen how the proposed Business Finance Partnership will allocate funding to supply chains.

We would be pleased to discuss these further with the Taskforce.

Yours faithfully

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## APPENDIX

### Improving Access to Non-bank Debt – Industry Task Force

#### ICAEW REPRESENTATION

#### WRITTEN EVIDENCE SUBMITTED ON 27 JANUARY 2012 BY ICAEW

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## INTRODUCTION

1. We are writing to provide evidence in response to the call for evidence by the Industry Task Force lead by Tim Breedon. ICAEW would be pleased to provide oral evidence on any aspect of its submission.

## WHO WE ARE

2. ICAEW is a world leading professional accountancy body supporting over 138,000 members in more than 160 countries. With a Royal Charter, we work in the public interest with governments, regulators and industry to maintain the highest business and ethical standards. We are also a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

## THE NON-BANK LENDING TASK FORCE

3. The Task Force under Tim Breedon, Chief Executive of Legal & General Group plc. comprises individuals with a formidable range and depth of experience of this issue . In particular we believe that the involvement of Christopher Rowlands, whose earlier report *Provision of Growth Capital to UK SMEs* published on 23 November 2009, is a significant starting point for the taskforce’s work on the supply of finance to fast growing companies. Furthermore, we understand the Task Force has been provided with significant civil service staff resources. There is already a wide variety of research reports into the topic of access to finance for the Task Force to draw upon, not least those commissioned by BIS.
4. But the Task Force has little time to undertake its work, if it is to report in time to inform the 2012 budget. In the light of this we have chosen to highlight a few key points in our evidence.

## RECOMMENDATIONS

**Banks will continue to play a key role in business access to finance.**

5. ICAEW conducted research into debt finance (*External Debt Financing of UK Businesses - One Year On*) seeking the views of 1,007 ICAEW members in businesses of all sizes in early 2011. It revealed the range of debt finance used by UK businesses. The following table illustrates the diversity.

### Type of external debt facility used

|                     | Total        | Large      | Small & Medium | Micro     |
|---------------------|--------------|------------|----------------|-----------|
| <b>Base</b>         | <b>1,007</b> | <b>477</b> | <b>432</b>     | <b>98</b> |
| None                | 35%          | 27%        | 41%            | 47%       |
| Overdraft facility  | 46%          | 53%        | 41%            | 34%       |
| Term loan           | 39%          | 42%        | 37%            | 36%       |
| Asset based finance | 21%          | 23%        | 21%            | 9%        |
| Loan notes          | 13%          | 21%        | 7%             | 3%        |
| Invoice discounting | 8%           | 8%         | 11%            | -         |
| Corporate bonds     | 7%           | 13%        | 1%             | 4%        |
| Mezzanine finance   | 4%           | 6%         | 2%             | 2%        |
| Debt factoring      | 4%           | 6%         | 3%             | 1%        |

Note: Size is defined by number of employees – Micro 1 to 9; Small 10 to 49; Medium 50 to 249; Large 250+

6. The overall make-up of debt facilities among businesses had broadly stayed the same as in a previous survey, a year earlier. Amongst those businesses with debt facilities, overdraft and term

loans were the most frequently used. With asset based finance some way behind. Loan notes, corporate bonds mezzanine finance and debt factoring are more used by large businesses. Invoice discounting is used in certain sectors by small and medium businesses.

7. The evidence above clearly shows that banks are still the first port of call for businesses requiring finance. However, in light of the Basel III requirements and the Coalition's intention to implement the report by the *Independent Commission on Banking*, it is likely that the success rates for loan/overdraft applications, as revealed by the BDRG Continental quarterly SME Finance Monitor (16% of overdraft applications and 31% of loan applicants ended up with no facility at all in addition to significant levels of discouragement amongst 'would-be seekers') will not improve in the foreseeable future. This has a number of policy implications, not least that alternatives to non-bank finance will become increasingly important. Banks must play an increased role in signposting businesses to the alternatives. The BBA, as part of its *Supporting UK Business* initiatives, is developing a new "*Finding Finance*" tool, a website which will help businesses find the finance they need using a variety of criteria. But banks must also work at local level to better signpost those businesses which seek bank finance but do not meet bank criteria for lending.

### Supply chain finance

8. ICAEW intends to establish a working group drawn from industry (including Jaguar Land Rover), the advisory community, funders, academics and others with an appetite to explore how participants in a supply chain may seek to provide funding for smaller companies, including Other Equipment Manufacturers (OEMs), in the chain. David Rogers from BIS and James Douglas of Deloitte and Member of the Task Force, will also participate. The initial objective of the working group will be to signpost potential supply chain finance issues and solutions, prior to the formal meeting of the Breedon Review on 10 February.

### Government must improve its business education of appropriate forms of finance

9. A key role of government is to improve the awareness of the differing types of business finance and advantages and drawbacks of each.
10. There is a range of advice available from government on access to finance The BusinessLink.gov website contains a variety of guides, tools, videos and information. The Businesslink.gov website has a similar tool to the 'Finding Finance' one being developed by the banks.
11. The ICAEW has supported the BIS Finance Fitness Campaign to improve finance and investment readiness in start-up and smaller businesses. However it is scheduled to last for only for three months. A longer term commitment is required.
12. In 2009 the ICAEW Corporate Finance Faculty also cooperated with BERR and Businesslink to produce a Best Practice Guideline on *SME Finance* which was distributed to the Faculty membership of over 6,000 and made freely available as a download from ICAEW's website. We approached BIS in early 2010 with a view to working with BIS to update the guideline. With appropriate support ICAEW would seek to disseminate the updated guideline to its wider membership as well as to BIS network.
13. The ICAEW urges the government to increase the information available on the multiplicity of schemes to help educate businesses about the options available.

### Innovative solutions are required but will take time to develop

14. The ICAEW Corporate Finance Faculty contributed to the NESTA report *Beyond the Banks: The case for a British Industry and Enterprise Bond* which was led by Sam Gyimah MP. The report suggested that 'UK Industry Investment Bonds' created by a vehicle to buy business loans from

banks and to securitise them, supported by a partial government guarantee, would significantly increase the diversity of finance available to UK businesses.

15. The report also highlighted that a UK market for small and medium-sized corporate bonds exists, despite its relatively small size. As the NESTA research highlights a number of companies too small to make the cost of issuing bonds worthwhile have taken advantage of a form of loan note, occasionally called 'shaving bonds' after an early bond designed and issued by King of Shaves in 2009. The report cites the example of Hotel Chocolat which raised a relatively small sum, £3.7 million, by the issue of bonds.
16. ICAEW supports further steps to develop these alternatives and extend their reach down the size scale. We would welcome the opportunity to highlight to our members further case studies of these infrequently used finance mechanisms.

#### Government should maintain current incentives

17. The ICAEW believes that government has a role to play in supporting a limited number of specifically targeted businesses with access to finance.
18. The Enterprise Finance Guarantee (EFG) has offered £1.63 billion to 16,095 businesses from inception to 30 September 2010 an average sum of £101,100.  
(<http://www.bis.gov.uk/policies/enterprise-and-business-support/access-to-finance/enterprise-finance-guarantee/efg-statistics>)
19. It is clear that the scheme is largely serving more established Small and Medium Enterprises (SMEs) while **in the experience of our members smaller businesses are put off by the requirement for joint and several guarantees**. This adversely impacts the very businesses experiencing most difficulty in accessing bank loans and overdrafts..
20. By way of contrast, HMRC's Business Payment Support Service (or Time to Pay scheme) has provided temporary relief to 444,400 businesses worth £7.71 billion from inception to the end of June 2011, the date of the last statistics release. The average value of the arrangements is £17,300. The sum of £6.69 billion has been repaid to HMRC.
21. A number of new measures were announced in the 2011 Autumn Statement:
  - The National Loan Guarantee Scheme to provide up to £20 billion of cheaper loans to businesses with a turnover up to £50 million
  - The Business Finance Partnership to invest up to £1 billion in loan funds alongside private sector co-investors
  - As well as extending from January 2012 the Enterprise Finance Guarantee to businesses with a turnover up to £44 million
22. The government has also extended the tax relief on Enterprise Investment Scheme to start-up and early stage businesses. Equity finance is outside the remit of the Task Force, but the ICAEW believes that government must continue to offer incentives to small scale equity investors as well as helping educate SMEs about the advantages of this type of finance.

#### Businesses need to understand the importance of good financial management and take advice when necessary

23. Undoubtedly, the environment for businesses to access finance is more difficult than before the 2008/9 recession, particularly for start-up and early stage businesses. Banks are much more risk averse and Basel III will continue that trend. This means that for a start-up business to access debt finance from a bank without security or adequate guarantees is very difficult, even assuming a good previous credit history.

24. An awareness of the importance of good financial management can result in businesses keeping within their own funding abilities as well as building a good credit score on which to base future access to finance applications. Good financial management requires prompt and reliable monthly management accounts in addition to audited financial statements. Many SMEs do not have a persuasive business plan on which to base finance applications. And many SMEs do not seek external advice when making bank finance applications – the Q3 2011 SME Finance Monitor reveals only 9% of those applying for / renewing an overdraft and 19% of those applying for a loan had sought any advice beforehand.
25. In 2011 the ICAEW started the **Business Advice Service** whereby ICAEW Chartered Accountants in over 3,000 offices across England, Scotland and Wales now offer SMEs advice, at no cost to the SME, on how to overcome the challenges they face in starting and growing a business. This followed on from an earlier initiative called SME Funding Adviser scheme whereby ICAEW Chartered Accountants identified the services they offered to SMEs to support their needs for a wide variety of finance. ICAEW provides technical support to its members in both schemes. We continue to provide the media with articles on the benefits of good financial management as well as the range of financing options available to business.

### **ICAEW – FURTHER SUPPORT FOR THE TASK FORCE**

26. The ICAEW welcomes the creation of the Task Force and offers its support. As we have outlined above the ICAEW has a core membership in the Finance community. We therefore would like to offer the **Task Force the opportunity to launch its report** at Chartered Accountants Hall in the heart of the City. We would also welcome the opportunity to work with the Task Force and the Government to spread awareness of its recommendations by hosting focus groups, or events around specific topics. We will, of course, report the Task Force findings to our UK members.

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