ICAEW

THE INSTITUTE OF CHARTERED ACCOUNTANTS

IN ENGLAND AND WALES

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# BANK FINANCE REPORT

A special report from The Institute of Chartered Accountants in England and Wales

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# INTRODUCTION

There are many reports about UK businesses struggling to secure finance from their banks due to the ongoing economic crisis. The Institute of Chartered Accountants in England and Wales (ICAEW) has conducted this research in order to better understand both the credit environment that our members currently face and which finance facilities their businesses rely on.

Between 29 October 2008 and 8 January 2009, 767 ICAEW members working in industry and commerce, often as company finance directors, were interviewed about the credit arrangements their organisations had with UK financial providers. Members were interviewed about the range of finance options that their businesses had in place and were asked detailed questions about the two of the most common forms of finance: term loans and overdrafts.

The individuals we interviewed came from a broad range of companies across all regions of the UK and all industry sectors, with the exception of banking and financial services sector firms. When you read the results, bear in mind that the mix of firms in which our members tend to be employed is not representative of all UK firms.

The ICAEW works in the public interest to promote enterprise, innovation and sustainable growth in a socially responsible business environment.

Our strength and knowledge is drawn from the expertise of over 132,000 members worldwide who hold world-class finance qualifications. Their experience gives us an acute understanding of the dynamics which drive our economy.

We hope that the findings of this work will help to advise the UK public policy effort to support businesses in the current challenging economic conditions.

Details about the profile of the organisations covered in this research are included in section 4.

# EXECUTIVE SUMMARY

- Both SMEs and large businesses currently hold a range of different sources of finance. Overdrafts, leasing/hire purchase and term loans are the most common.
- Small and medium-sized enterprises in London and the South East are less likely to have external finance sources in place than those in other regions of the UK, a phenomenon apparently driven by variation in the mix of businesses in these regions. The Business Services sector, which is more important in the South relative to the national average, is less likely than other sectors to have these forms of financing. However, less regional variation is evident for larger businesses.
- Overdrafts are the most common form of finance for all sizes of business. This research indicates that most SMEs with overdrafts see a continued need for this source of funding. Of the 200+ SMEs with an overdraft interviewed, only a very small minority intend not to retain it when it is next up for renewal.
- Most SMEs with an overdraft facility in place report that their largest overdraft will be up for renewal before the end of 2009. The vast majority – 86% – expected to stay with their current provider.
- We cannot assume that renewal discussions with finance providers will result in changes which might threaten business success, or indeed that the success of these firms is dependent on the availability of their overdrafts. However, it is reasonable to assume that the people running these businesses may draw comfort from any Government back-up to their funding position which may be available.
- Most firms with a term loan report that their current largest term loans will be in place until at least 2010.

# FINDINGS

## I. OVERDRAFTS

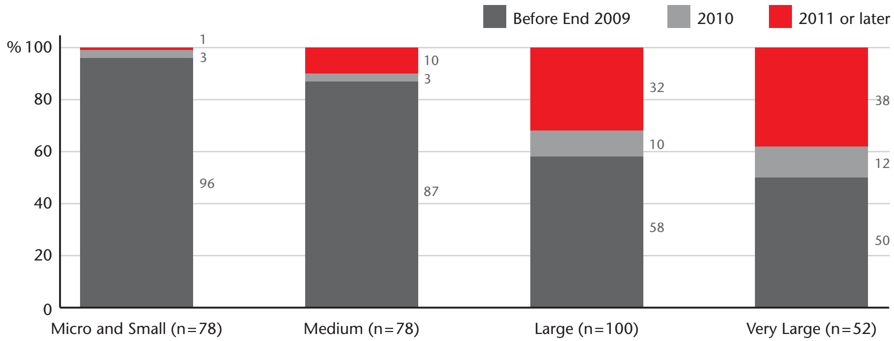
Overdrafts are the most common source of finance for all sizes of business and they can be vital in managing cash flow. It is unlikely that smaller firms will have more than one overdraft facility in place, but some large firms could have multiple overdrafts. For simplicity of questioning, this survey only focused on each firm's largest overdraft facility.

We asked interviewees about the value of their largest overdraft facility and when this was up for renewal. We also asked whether, within the last six months, their provider had been in touch with them regarding their facility and whether they planned to change provider once their current facility was up for renewal.

Most SMEs with an overdraft facility in place report that their largest overdraft will be due for renewal before the end of 2009.

**Fig. 1 When largest overdraft due for renewal**

When is this overdraft facility up for renewal?




NOTE: This data is based on those who were able to give an answer to the question. 'Don't know' responses were more common in large businesses than in small ones. By excluding the 'Don't know' answers, we assume that behaviour in firms where the contact was unable to give an answer is in line with that reported by those who did answer the question. While standard practice, this may not be the case. In addition, a few firms contacted early in the fieldwork period reported overdrafts due for renewal during 2008. These have also been excluded from the analysis above.

What does this mean for medium-sized firms?

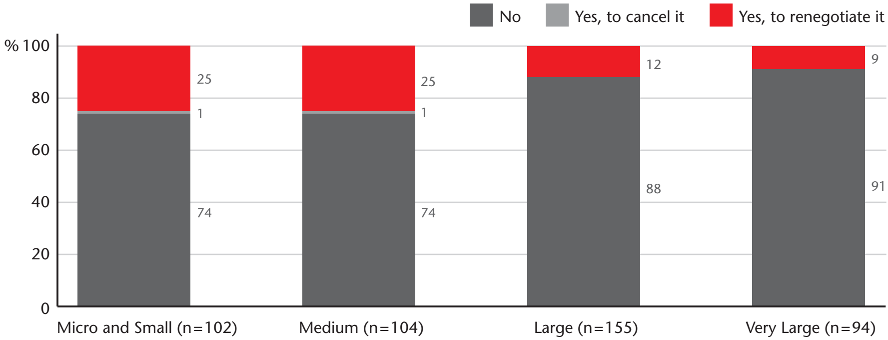
- According to the Department for Business, Enterprise and Regulatory Reform (BERR), the UK economy has some 26,000 medium-sized firms. BERR's Enterprise Directorate Analytical Unit estimates that medium-sized businesses account for around 2.6m jobs and almost £400bn or 14% of total turnover of all UK enterprises.
- Our data indicates that around six in ten medium-sized firms (62%) have an overdraft facility, which equates to approximately 16,000 firms.
- Of these, almost nine in ten (something around 14,000 firms or a little over half of all medium-sized firms) expect to be talking with their bank about the terms of their overdraft before the end of this year.

While we cannot assume that all of these conversations will result in changes which might threaten business success, or indeed that the success of these firms is dependent on their overdrafts, it is reasonable to assume that those running the businesses concerned may draw comfort from any Government back-up to their funding position which may be available.

While most firms had not been contacted by their providers to renegotiate or cancel overdrafts within the six months prior to interview, there is a different pattern for small and large businesses. Over one quarter (26%) of SMEs giving an answer report that their provider has been in touch with them to renegotiate or cancel their largest overdraft facility in the last six months, compared to 12% of large businesses and 9% of very large businesses.

**Fig. 2 Contact by finance provider – largest overdraft**

Has your finance provider contacted you to renegotiate or cancel your overdraft within the last six months?




NOTE: As in chart 1, this data is based on those able to give an answer to the question. 'Don't know' responses were more prevalent among large than among small businesses.

We have considered several potential reasons for these differences, including seasonal trends in firms' accounting periods and financial planning, but we have not been able to substantiate specific possible explanations.

In the absence of other evidence, this data does suggest that financial institutions were, through the second half of 2008, somewhat more likely to make contact about overdrafts with smaller firms than with larger firms.

It may be that banks have been contacting smaller businesses who are not using their whole overdraft facility to suggest a change. This might be relatively painless as we know from other work that SMEs often have overdrafts simply to provide cash flow flexibility and back-up. This would also be in line with anecdotal feedback.

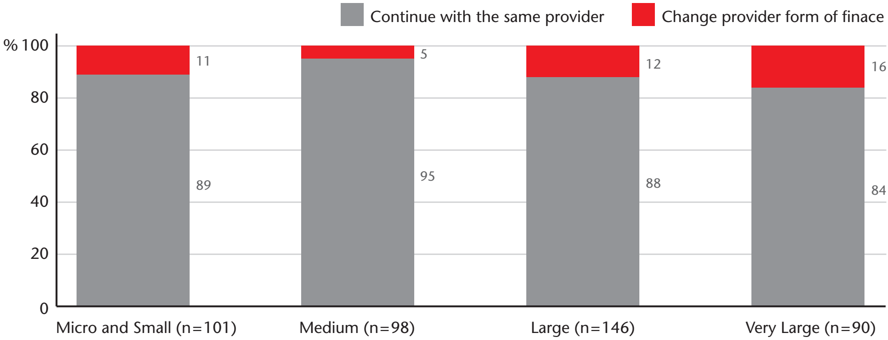
Alternatively, it could be that banks are placing somewhat greater emphasis on managing the risk represented by small business as opposed to large business overdraft provision.

Either way, this trend does not appear to have had any impact on SMEs propensity to review their relationship with their current providers once the overdraft in question is up for renewal.

This may be due to the perception that it is difficult to get good credit facilities anywhere in the current financial climate. In fact a marginally greater proportion of SMEs expect not to change provider or switch to a different form of finance than is the case for large businesses.

**Fig. 3 Firms' plans for largest overdraft upon renewal**

When this overdraft is up for renewal which of the following do you expect to do: continue with the same provider; switch to an international provider; switch to another financial provider in the UK; switch to other types of finance; or something else?

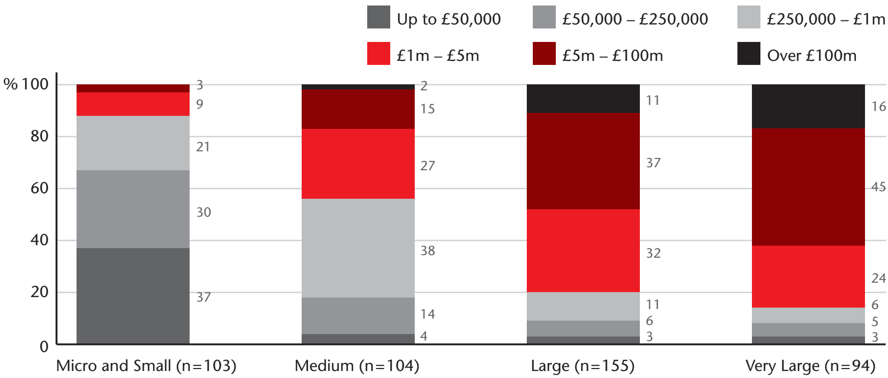



NOTE: As above, this data is based on those able to give an answer to the question. 'Don't know' responses were more prevalent among large than among small businesses.

As would be expected, there is a strong relationship between company size and the value of the company's largest overdrafts.

**Fig. 4 Value of largest overdraft facility**

What is the value of your organisation's largest overdraft facility?




NOTE: As above, this data is based on those able to give an answer to the question. 'Don't know' responses were more prevalent among large than among small businesses.

# II. TERM LOANS

Terms loans are commonly used by both large and small businesses, usually to fund asset purchases such as property or plant and machinery. They are also sometimes used to fund working capital, although other forms of finance, particularly overdrafts, are more commonly used for this purpose. It is reasonable to assume some firms – especially larger firms – will have more than one term loan in place.  Research by the Cambridge University Centre for Business Research (*Financing UK Small and Medium-sized Enterprises, 2007*) found that 57% of SMEs with a commercial loan had just one loan while a further 24% had just two. For simplicity of questioning this survey focused on each firm's largest term loan only.

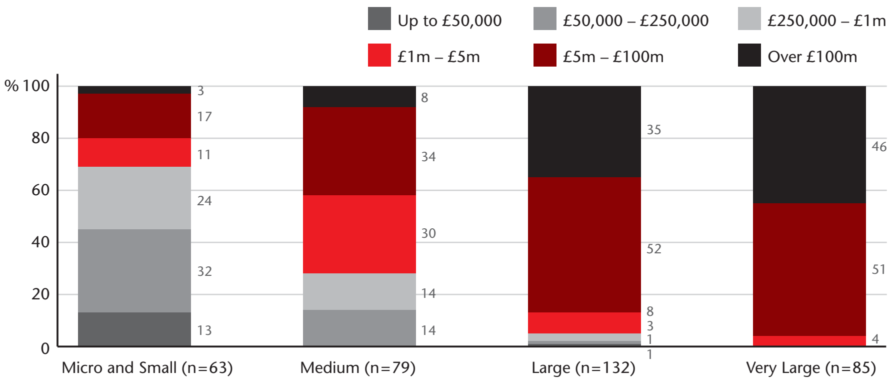
We asked the interviewees about the value of their largest term loan and when this was up for renewal. We also asked:

- whether their largest term loan had been renegotiated in the last year, and if so whether the terms had become more or less stringent, or stayed the same;
- whether their provider had been in touch with them regarding their largest term loan facility; and
- whether they planned to change provider once their largest term loan was up for renewal.

As with overdrafts, the expected pattern of correlation between the size of the largest term loan and company size is evident.

**Fig. 5  Value of largest term loan**

What is the value of your organisation's largest term loan facility?




NOTE: As above, this data is based on those able to give an answer to the question. 'Don't know' responses were more prevalent among large than among small businesses.

Only a quarter of SME firms (26%) reported that they had re-negotiated their largest term loan within the last year, marginally less than for large firms where one third (35%) had re-negotiated in the last year.

This survey reveals no evidence of a different approach by lenders to small and large businesses regarding changes to the basis on which term loans have been offered for those re-negotiating in the last year. A similar proportion of SME and large firms (about half) report the terms and conditions of their term loans became more stringent upon re-negotiation. The majority of these reported that the cost of the loan had increased, either by a higher interest rate, higher arrangement or other fees, or both.

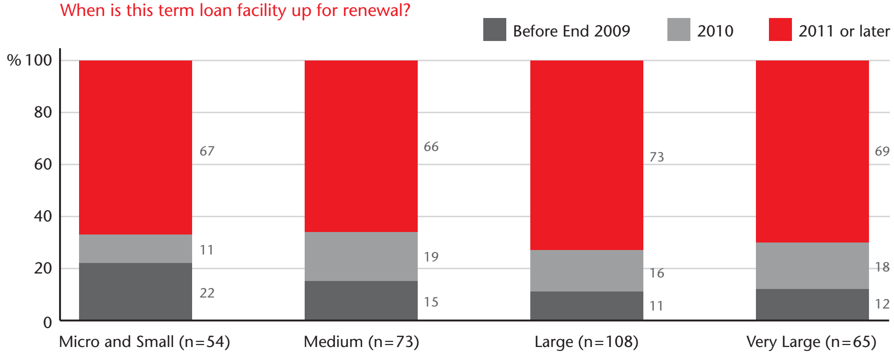
Typical explanations of changes to more stringent terms include:

- 'Higher interest rates and arrangement fee, security hasn't changed, the covenants are harsher, tighter conditions on ratio of interest to overall debt.'
- 'Shorter term and more assets backing required'
- 'The amount of equity needed to support the term loan; looking at the equity: debt ratio of the business.'
- 'There was a much higher need for security; the lender was much stricter on the security of the loan.'
- 'The bank re-wrote the conditions of the loan in their favour and said we could take it or leave it.'

Also, in contrast to the findings for overdrafts, most firms report that their current largest term loans will be in place until at least 2011.

**Fig. 6 When largest term loan due for renewal**

When is this term loan facility up for renewal?

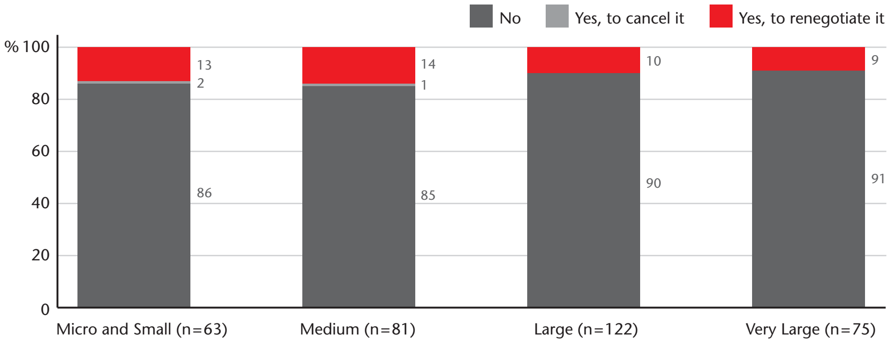



NOTE: As above, this data is based on those able to give an answer to the question. 'Don't know' responses were more prevalent among large than among small businesses. In addition, a few firms contacted early in the fieldwork period reported terms loans due for renewal during 2008. These have also been excluded from the analysis above.

In line with a tendency for term loans to be set for a relatively long period of time among this sample of businesses, most firms report that their lenders have not been in touch to re-negotiate or cancel their largest term loan.

### Fig. 7 Contacts by finance providers – largest term loan

Has your finance provider contacted you to renegotiate or cancel your overdraft within the last six months?



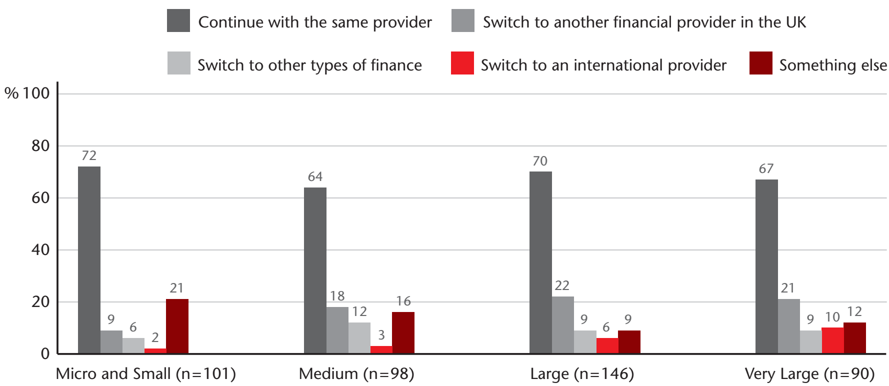

NOTE: This data is based on those able to give an answer to the question. 'Don't know' responses were more prevalent among large than among small businesses. By excluding the 'Don't know' answers we assume behaviour in firms where the contact was unable to give an answer is in line with that reported by those who did answer the question. While standard practice, this may not be the case.

As we found for overdrafts, firms are largely unlikely to expect to change provider once their current largest term loan is up for renewal. However, plans to 'shop around' were more common than was the case for overdrafts with some – particularly among larger firms – considering overseas lenders.

Those indicating that they planned to do 'something else' were mainly expecting to pay off the loan.

### Fig. 8 Firms' plans for largest term loan upon renewal

When this term loan is up for renewal which of the following do you expect to do: continue with the same provider; switch to an international provider; switch to another financial provider in the UK; switch to other types of finance; or something else?




NOTE: As above, this data is based on those able to give an answer to the question. 'Don't know' responses were more prevalent among large than among small businesses.

# III. CURRENT SOURCES OF FINANCE

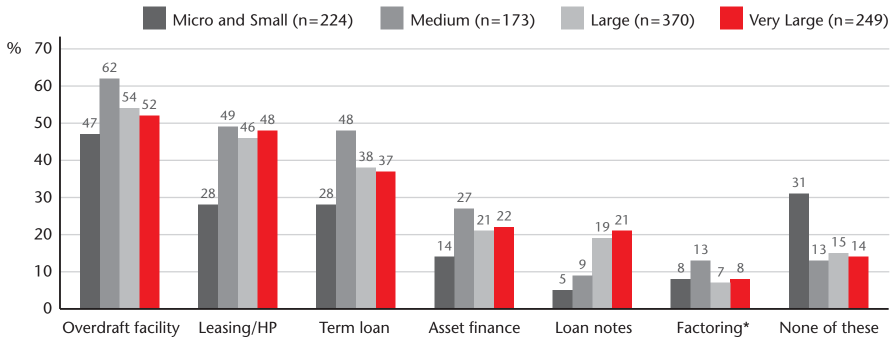
We asked firms which of a range of sources of finance they had in place. When considering this data it is important to bear in mind that the list of possible sources was not exhaustive.

The most common finance facility (from the list offered) for all sizes of business is an overdraft, with medium-sized businesses more likely than other businesses to report having an overdraft facility.

Medium-sized firms are also most likely to have at least one term loan in place, while leasing and hire purchase arrangements are somewhat more common than term loans among large businesses.

**Fig. 9 Sources of finance – all businesses**

Which of the following sources of finance does your organisation have with any of the UK financial providers?



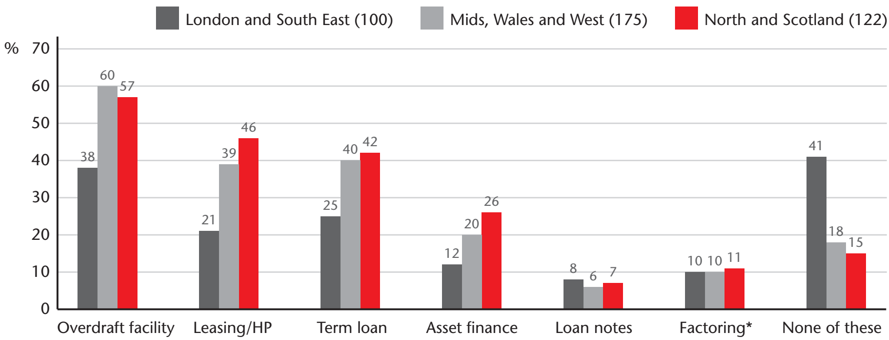

* Factoring and invoice discounting

A greater proportion of micro and small businesses have none of these forms of finance in place compared to either medium-sized or large firms.

SMEs in London and the South East are particularly likely not to be currently using any of these finance arrangements. They also report lower levels of use for all the more common types of finance arrangement than SME businesses in other parts of the UK.

## Fig. 10 Sources of finance – SMEs by region

Which of the following sources of finance does your organisation have with any of the UK financial providers?

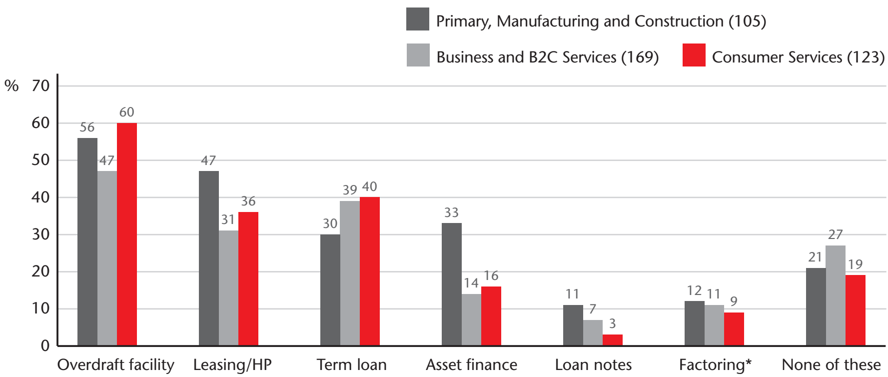



* Factoring and invoice discounting

This trend appears to be driven by a variation in the mix of business types across different regions. In the South, the Business Services sector makes a greater contribution to the economy than is the case for the UK as a whole and it is businesses services firms which are less likely than others to have these forms of financing in place.

## Fig. 11 Sources of finance – SMEs by sector

Which of the following sources of finance does your organisation have with any of the UK financial providers?




* Factoring and invoice discounting

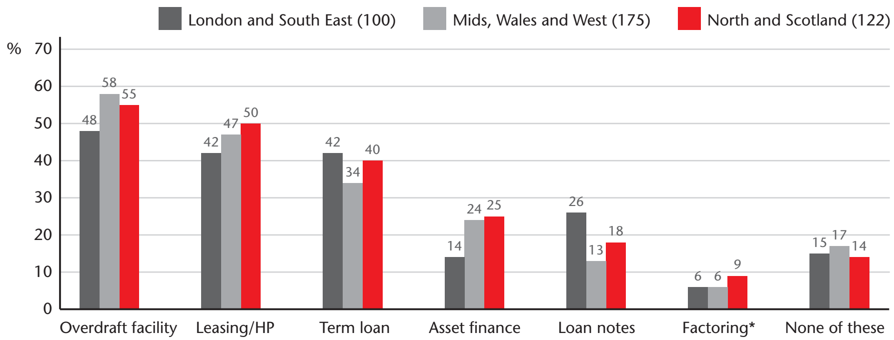
NOTE: Sector groupings have been collapsed into three broad categories as the number of observations in the dataset is relatively limited. Definitions are as follows:

- **Primary, Manufacturing & Construction** includes all agricultural activities, mining, quarrying and electricity, gas and water supply, although this group is primarily made up of manufacturing and construction firms.
- **Business & B2C Services** covers transport, communications, property, and business services.
- **Consumer Services** covers retail and wholesale, hotels and catering, other services, and health and education.

The proportion of large businesses with none of the listed forms of finance in place varies less by region than is the case for SMEs. However large firms in the South are more likely than those in other regions to have loan notes in place, and they are somewhat less likely to be reliant on overdrafts and asset finance.

**Fig. 12 Sources of finance – large businesses by region**

Which of the following sources of finance does your organisation have with any of the UK financial providers?




* Factoring and invoice discounting

# TECHNICAL DETAILS

This research was conducted by The Institute of Chartered Accountants in England and Wales (ICAEW).

During the period 29 October 2008 - 8 January 2009, 767 members of the ICAEW who work in industry and commerce (ie, outside accountancy practice) were interviewed about the sources of finance their organisations had with UK financial providers.

Interviews were conducted by telephone.

We asked interviewees which of a range of finance options they had in place. We then asked more detailed questions about two of the most common forms of finance – term loans and overdrafts – including the value of the largest facility in place and when this was due for renewal.

The individuals who were interviewed were from a broad range of companies across all regions of the UK and all industry sectors, with the exception of banking and financial services sector firms. Roughly half were from small and medium-sized enterprises (up to 249 employees) and the other half represented larger companies.

This sample of SMEs versus large businesses is not in line with the incidence of sizes of business in the UK as a whole. Behaviour reported in this survey varies considerably between small and large businesses; hence the results for different sizes of businesses are reported separately.

Readers should bear in mind that, due to the types of firms ICAEW members tend to be employed in, the companies covered here tend to skew towards the larger end of SME (those with 50 – 249 employees) and to the very large end of large businesses (1,000+ employees). This means that, for example, data for SMEs overall will be skewed towards the behaviour of larger SMEs if there are differences in behaviour or attitudes by size of business. Generally we present the results for micro and small, and medium-sized businesses separately for this reason, and also show results for very large businesses alongside those for all large businesses.

Behaviour reported in this survey varies considerably in line with business size, hence the results for different sizes of businesses are reported separately.

The table opposite describes the profile of the businesses contacted in this survey.

| REGION | Sample Number | Profile % |
|---|---|---|
| London | 94 | 12 |
| South East (excl London) | 116 | 15 |
| South West | 72 | 9 |
| East England | 65 | 8 |
| East Midlands | 60 | 8 |
| West Midlands | 61 | 8 |
| North West | 78 | 10 |
| Northern England | 57 | 7 |
| Yorks & Humber | 59 | 8 |
| Scotland | 50 | 7 |
| Wales | 54 | 7 |
| Northern Ireland | 1 | 0 |
| **TOTAL** | ***767*** | |
| **SIZE (EMPLOYEES)** | | |
| Micro & Small (up to 49) | 224 | 29 |
| Medium (50-249) | 173 | 23 |
| Large (250+) | 370 | 48 |
| **TOTAL** | ***767*** | |
| **SECTOR** | | |
| Agriculture and fisheries, energy, water and mining | 65 | 8% |
| Manufacturing and Engineering | 106 | 14% |
| Construction | 56 | 7% |
| Retail and Wholesale | 86 | 11% |
| Hotels and Catering | 56 | 7% |
| Transport and Storage | 57 | 7% |
| Communications | 47 | 6% |
| IT | 63 | 8% |
| Property | 59 | 8% |
| Business services | 60 | 8% |
| Other service activities | 58 | 8% |
| Health and Educations | 54 | 7% |
| **TOTAL** | ***767*** | |

## FURTHER INFORMATION

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For further information about the ICAEW Strategic Research programme please visit www.icaew.com

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