ICAEW

# ICAEW BUSINESS OPINION

## EXTERNAL DEBT FINANCING OF UK BUSINESSES – ONE YEAR ON

June 2011 Research report

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# FOREWORD

ICAEW's latest findings from our series of reports into business debt financing show that UK businesses are moving to a more sustainable model of financial management and learning to survive with less debt.

Our report – continuing the trend from last year's findings on businesses' use of external debt financing – reveals that only a small proportion of businesses are seeking to open new external debt facilities. Most are managing operations within their existing debt facilities through improved financial management. This low level of demand for new credit helps explain why recent lending figures have fallen short of Project Merlin targets.

We think businesses are right to take this sensible approach given the economic environment. Our recent *ICAEW/Grant Thornton UK Business Confidence Monitor* suggests the economy faces a long, slow road to recovery. Despite the Confidence Index increasing in the last quarter, overall, business confidence has fallen over the past year.

Our research also shows that the lending environment has improved over the past year. This suggests that lenders are beginning to deliver on the recommendations made by the BBA's Business Finance Taskforce in their report *Supporting UK Business*. However, there remains a challenge to ensure a lending environment conducive to growth for all sizes of business in all sectors. ICAEW Chartered Accountants in larger businesses reported a greater improvement than those in SMEs and businesses in the Property sector remain far more likely to experience pressures from lenders.

We believe long-term sustainable UK growth will only be realised when government, businesses and individuals adjust to a world with less debt. This report suggests that businesses are taking positive steps towards a more sustainable model of financial management.

Michael Izza

**Michael D M Izza**
Chief Executive
ICAEW

# INTRODUCTION

Between 1 February and 11 May 2011, we interviewed 1,007 ICAEW Chartered Accountants who work in industry and commerce (ie, outside accountancy practice). We asked members about their organisation's use of external debt facilities and how lenders administer these facilities.

We also asked about their level of success in renewing existing debt facilities and whether they had a need to apply for a new facility. This report follows a comparable survey conducted among ICAEW members in 2010 and provides an opportunity to assess any changes in the lending environment since last year.

Consistent with 2010, many firms are continuing to optimise their existing debt facilities, rather than applying for new ones. This suggests that many businesses are continuing their cautious approach as they adapt to the new economic environment.

Businesses have experienced some degree of relaxation in the lending environment in the past 12 months, both in the way lenders manage existing facilities and in relation to the terms that businesses face when renewing debt finances. However, a significant number of those renewing an existing debt facility still report an increase in the cost of borrowing compared to their previous arrangements. Overall, larger businesses appear to have benefited the most from this relaxation in the lending environment.

The individuals interviewed came from Micro, Small & Medium and Large companies across all regions of the UK and industry sectors. You can find information about the profile of the organisations covered in this research in the technical details section on page 8.

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 136,000 members worldwide, who hold world-class finance qualifications. Their experience gives us a detailed understanding of the dynamics that drive our economy.

# FINDINGS

**Fewer businesses have experienced pressure from their main lender's administration of their debt facilities. Large businesses are most likely to feel some degree of relaxation.**

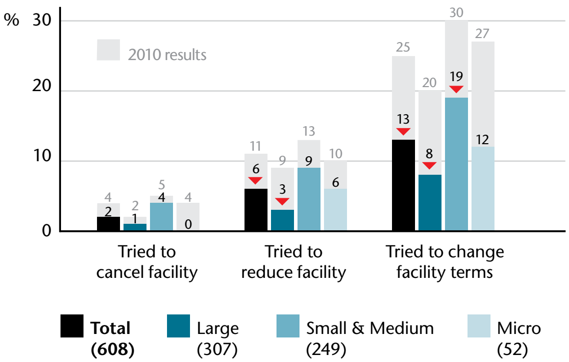
Consistent with 2010, just under two thirds (63%) of organisations currently have an external debt facility.

Since 2010 there appears to be some degree of relaxation in the lending environment – the proportion of businesses who report that their main lender has attempted to alter their existing debt facility in the past 12 months has almost halved from 29% to 15%. This shift is noticed across organisations of all sizes.

- Compared to last year, fewer businesses report attempts by their lender to change the terms of a debt facility (Fig 1). Furthermore, a smaller proportion of firms this year report that their main lender has become more stringent in applying the terms of their facility (Fig 2).

### Fig 1. Attempted changes to debt facilities by lenders

Has your organisation's main lender tried to make any of the following changes to your organisation's debt facility in the last 12 months?

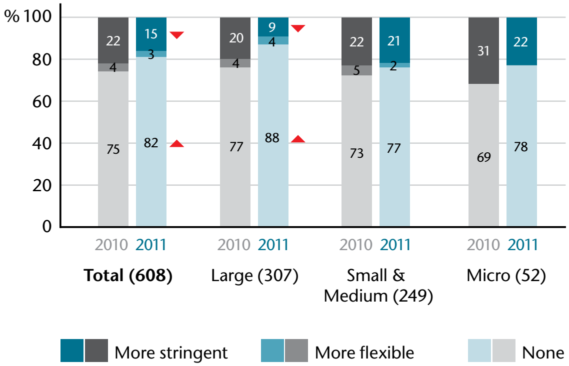



Base: those with an external debt facility

Note: Where there has been a significant change from 2010 to 2011, this is denoted by up or down arrows on each chart.

### Fig 2. Changes in the way lenders apply the terms of debt facilities

Has your organisation's main lender changed the way it applies the terms of your organisation's main facility, eg, technical breaches of covenants, in the last 12 months?




Base: those with an external debt facility

It is among Large businesses that we see the biggest shift since 2010; the proportion reporting more stringent terms being applied to their facility in the past 12 months has halved since 2010.

**Some relaxation in the lending environment for businesses renewing existing debt facilities, yet significant numbers continue to report increased arrangement fees or interest rates.**

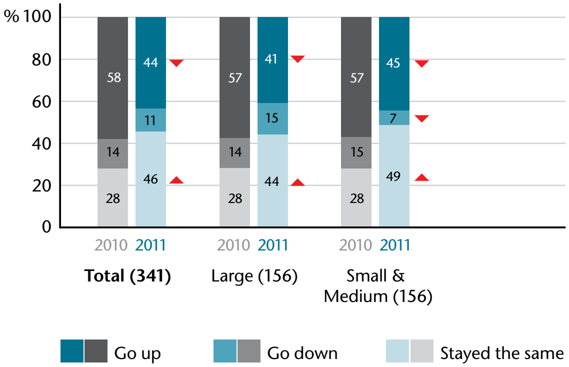
In line with 2010, the majority of businesses who have tried to re-finance an existing debt facility in the past 12 months were successful.

Among firms that renewed their debt facility in the past 12 months, fewer report higher costs of borrowing compared to 2010, and more firms report that their costs have stayed the same in terms of:

- interest rates (Fig 3); and
- arrangement fees, driven by the shift among Small & Medium businesses (Fig 4).

## Fig 3. Changes to interest rates when renewing existing debt facilities

Did the interest rate for this debt facility go up, down or stay the same compared to the previous arrangement?

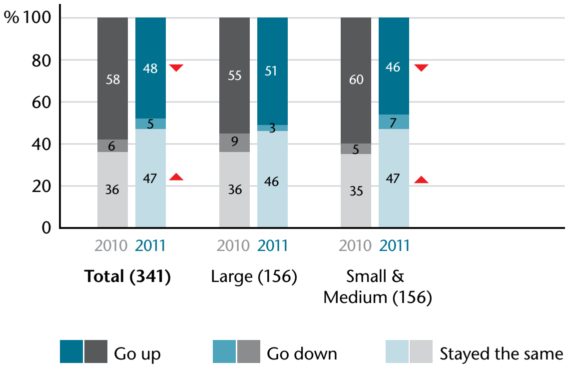



Base: all able to renew an existing external debt facility

Note: Only answers with base 40+ are shown here.

## Fig 4. Changes to arrangement fees when renewing existing debt facilities

Did the arrangement fee for this debt facility go up, down or stay the same compared to the previous arrangement?




Base: all able to renew an existing external debt facility

Note: Only answers with base 40+ are shown here.

Despite these shifts, there is still a significant proportion of businesses this year whose costs went up when they renewed their facility. These increases in the cost of the existing facility could have a knock-on effect on businesses' demand for new borrowing.

The overall make up of debt facilities among businesses has broadly stayed the same since 2010 (Fig 5).

## Fig 5. Type of external debt facility used

Which type of external debt facility does your organisation currently have?

| | Total | Large | Small & Medium | Micro |
|---|---|---|---|---|
| Base | 1,007 | 477 | 432 | 98 |
| 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% |

**Demand for new debt facilities remains limited. Most businesses claim that their turnover growth is not reliant on their ability to increase debt financing.**

As was the case in 2010, less than one in five organisations had a need to apply for a completely new external debt facility in the past 12 months. This may suggest that businesses are still being cautious about increasing their costs given the current weak growth of the UK economy, recent inflationary pressures and uncertainty about the full impact of the public sector cuts on the economy.

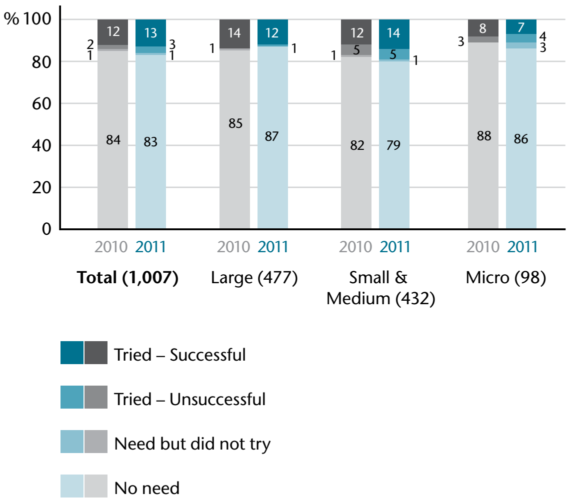
The proportion of businesses that did apply for new finances and were successful is also consistent with 2010 (Fig 6). The majority were successful in obtaining new finance, but smaller companies continue to be significantly less successful than Large businesses in obtaining a new debt facility.

Consistent with 2010, the majority of businesses are meeting their needs by optimising existing debt facilities in addition to their own cash generation. This suggests that businesses are continuing to focus on fundamentals, through cost control, cash and debt management, and are trying to reduce their reliance on additional debt finance.

### Fig 6. Success in applying for a new external debt facility

In the last 12 months, has your organisation had a need to apply for a completely new external debt facility?

In the last 12 months, has your organisation tried to apply for new external debt facility? Was your organisation able to obtain the new debt facility?




Base: all respondents

This year we investigated reasons for businesses applying for new debt facilities, and the results show a mixed picture. The primary reasons given were to cover working capital (particularly for Micro and Small businesses) and/or for capital expenditure. In addition, a number of Large businesses reported seeking new debt to fund the acquisition of another company.

In 2011, we also looked at alternative options for debt and found that just under one in ten businesses of all sizes have raised share capital in the last 12 months. Most commonly it was raised from existing private shareholders.

Looking towards the future, two thirds of businesses continue to say that their turnover growth over the next two years is not reliant on their ability to increase levels of debt. Consistent with last year, a higher proportion of Small & Medium (38%) businesses remain more reliant than Large businesses (30%) on their ability to increase external debt for turnover growth.

# APPENDIX

## KEY FINDINGS BY SECTOR

As was the case in 2010, businesses in the Property sector tend to experience more pressure than other sectors from their main lender in the administration of their main debt facility. Almost three in ten businesses in the Property sector report that the terms of their main facility have become more stringent in the past 12 months.

| | Business Services | Construction | IT | Manufacturing and Engineering | Primary | Property | Retail and Wholesale | Transport and Storage | Other Services |
|---|---|---|---|---|---|---|---|---|---|
| **All Respondents** | N=122 | N=87 | N=54 | N=187 | N=76 | N=95 | N=161 | N=76 | N=65 |
| Currently has an external debt facility | 50% | 71% | 39% | 63% | 66% | 81% | 66% | 69% | 52% |
| In the last 12 months, has had a need to apply for a completely new external debt facility | 15% | 8% | 8% | 14% | 37% | 34% | 18% | 18% | 15% |
| Turnover growth in the next two years reliant on ability to increase external debt financing | 27% | 29% | 25% | 31% | 43% | 47% | 37% | 47% | 14% |
| **Those with access to an external debt facility** | N=49 | N=47 | | N=82 | N=42 | N=62 | N=82 | N=40 | |
| In the last 12 months have tried to renew an existing external debt facility | 61% | 66% | ** | 70% | 81% | 81% | 77% | 78% | ** |
| **Those who have an external debt facility** | N=58 | N=60 | | N=114 | N=47 | N=75 | N=100 | N=50 | |
| Organisation's main lender has made the terms of debt facility more stringent | 13% | 19% | ** | 14% | 14% | 28% | 12% | 16% | ** |
| In the last 12 months, main lender has tried to … | | | | | | | | | |
| Cancel facility | 0% | 0% | ** | 2% | 2% | 7% | 2% | 0% | ** |
| Reduce facility | 2% | 7% | ** | 5% | 2% | 14% | 8% | 0% | ** |
| Change facility terms | 11% | 10% | ** | 7% | 21% | 24% | 13% | 9% | ** |

**NOTE: Only answers with base 40+ are shown here. Findings from sectors with a base of less than 50 should be treated with caution.

# KEY FINDINGS BY REGIONS

The proportion of businesses in the East Midlands and Yorkshire and Humberside who have had more stringent terms applied to their main facility has remained broadly the same as last year, with one fifth having more stringent terms applied to their main debt facility in the past 12 months.

| | London | South East (excl. London) | South West | East England | East Midlands | West Midlands | North West | Northern England | Yorks & Humber | Scotland | Wales |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **All Respondents** | N=141 | N=154 | N=75 | N=91 | N=75 | N=76 | N=106 | N=74 | N=83 | N=62 | N=70 |
| Currently has an external debt facility | 59% | 61% | 69% | 64% | 62% | 61% | 61% | 69% | 70% | 68% | 60% |
| In the last 12 months, has had a need to apply for a completely new external debt facility | 22% | 15% | 28% | 20% | 12% | 10% | 22% | 16% | 18% | 19% | 14% |
| Turnover growth in the next two years reliant on ability to increase external debt financing | 32% | 31% | 40% | 38% | 26% | 38% | 32% | 34% | 40% | 30% | 30% |
| **Those with access to an external debt facility** | N=65 | N=72 | N=40 | N=43 | | | N=50 | | N=47 | | |
| In the last 12 months have tried to renew an existing external debt facility | 68% | 69% | 68% | 79% | ** | ** | 74% | ** | 79% | ** | ** |
| **Those who have an external debt facility** | N=78 | N=91 | N=48 | N=55 | N=46 | N=43 | N=63 | N=48 | N=56 | | N=41 |
| Organisation's main lender has made the terms of the debt facility more stringent | 7% | 10% | 17% | 10% | 21% | 14% | 18% | 16% | 22% | ** | 10% |
| In the last 12 months, main lender has tried to … | | | | | | | | | | | |
| Cancel facility | 4% | 4% | 0% | 2% | 2% | 0% | 2% | 2% | 0% | ** | 5% |
| Reduce facility | 7% | 5% | 6% | 6% | 5% | 5% | 5% | 2% | 4% | ** | 10% |
| Change facility terms | 17% | 6% | 15% | 9% | 17% | 12% | 15% | 18% | 6% | ** | 8% |

**NOTE: Only answers with base 40+ are shown here. Findings from regions with a base of less than 50 should be treated with caution.

# TECHNICAL DETAILS AND ACKNOWLEDGMENTS

Between 1 February and 11 May 2011, we interviewed 1,007 ICAEW Chartered Accountants who work in industry and commerce (ie, outside accountancy practice).

The interviews were conducted by telephone as part of the *ICAEW/Grant Thornton UK Business Confidence Monitor.*

Those interviewed are from Micro, Small & Medium and Large organisations, located across the UK and based in a broad range of industry sectors. Just over half of those surveyed (530) are from Micro, Small and Medium-sized enterprises (up to 249 employees); the other half (477) represent companies of 250 or more employees.

When reading the results, bear in mind that the sample of Micro, Small and Medium businesses, compared to Large ones, is not in line with the incidence of sizes of these businesses in the UK as a whole.

The figures in this report are based on those answering each question (they exclude the 'Don't know' responses). The actual base of those being able to answer a question is shown in each case.

Where there has been a significant change from 2010 to 2011 (at the 95% confidence level), this is denoted by up or down arrows on each chart.

The table on the following page describes the profile of the organisations contacted in this survey.

## Acknowledgments

Interviewing was undertaken by Kudos Research.

Kudos Research specialises in premium quality, custom-tailored UK and international data collection, as well as data analysis and research advisory services. Kudos Research interviews customers, stakeholders, business leaders and opinion formers across the globe, online and by telephone, as well as recruiting them for focus groups and depth interviews.

## Further information

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| REGION | No of interviews |
|---|---|
| London | 141 |
| South East (excl. London) | 154 |
| South West | 75 |
| East England | 91 |
| East Midlands | 75 |
| West Midlands | 76 |
| North West | 106 |
| Northern England | 74 |
| Yorkshire and Humberside | 83 |
| Scotland | 62 |
| Wales | 70 |
| **TOTAL** | **1,007** |

| SECTOR | No of interviews |
|---|---|
| Business services | 122 |
| Communications | 23 |
| Construction | 87 |
| Health and Education | 36 |
| Hotels and Catering | 25 |
| IT | 54 |
| Manufacturing and Engineering | 187 |
| Other Services | 65 |
| Primary* | 76 |
| Property | 95 |
| Retail and Wholesale | 161 |
| Transport and Storage | 76 |
| **TOTAL** | **1,007** |

*Primary includes agriculture and fisheries, energy, water and mining

| SIZE (EMPLOYEES) | No of interviews |
|---|---|
| Micro (1–9) | 98 |
| Small (10–49) | 212 |
| Medium (50–249) | 220 |
| Large (250+) | 477 |
| **TOTAL** | **1,007** |

Global Accounting Alliance

ICAEW is a founder member of the Global Accounting Alliance, which represents around 775,000 of the world's leading professional accountants in over 165 countries around the globe, to promote quality services, share information and collaborate on important international issues.

ICAEW is a professional membership organisation, supporting over 136,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.

Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.

**Because of us, people can do business with confidence.**

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