



The business people – an extension to your team

Cash Flow and Finance Panel Report

October 2011

Introduction

The Forum of Private Business is a proactive, not-for-profit organisation providing comprehensive support, protection and reassurance to small businesses. We add value to businesses through the collective voice for members in local, central and European government, and the provision of tailored solutions that promote business success.

Our Cash Flow and Finance Panel comprises approximately 90 members who have volunteered to provide feedback to us on financial matters. We engage regularly with the business owners on our Member Panels to better understand and collect evidence of their real life experiences, to more effectively reinforce our policy and campaigns activities.

Note: as figures refer to just over 90 businesses, they should be treated as indicative rather than representative of all small and medium-sized businesses.

Summary

Cash flow

At present, the main financial concerns for businesses are the rising cost of doing business (55%) and late payment/cash flow issues (25%). These were above the traditional concerns of the cost, accessibility and choice of finance.

The most effective ways of minimising late payment are at the front end of a contract. Deposits before starting work, invoicing promptly and getting to know staff in the customer's finance department are seen as particularly effective. Charging interest for late payment and using the law to get satisfaction are the least effective solutions and most likely to be counterproductive. There remains a preference for businesses to chase invoices directly, rather than through a third party - the process of invoice factoring. A significant minority of businesses have increased the amount of money allocated for late payment and bad debts, but few businesses have considered increasing the amount of bridging finance used.

Finance

There is good awareness of new entrants to the UK banking market with Virgin, Santander, Metro and Funding Circle all being mentioned by name. Others mentioned foreign banks or ethical institutions but those that expressed an opinion doubted whether these organisations were any different. The perceived advantages of alternative lenders are better customer service, spreading the risk of lending, better risk assessment amongst some providers and less stringent terms from others.

However, there are still significant barriers for financial organisations looking to enter the UK market with advertising/awareness, branch network and cost issues. Furthermore, alternative providers are considered risky since the demise of the Icelandic Banks and Northern Rock. A local branch network remains important for members. Nearly three quarters of panel members would reconsider their financial provision if their local branch closed, identifying this with the quality of customer service and the ability to pay in cheques or cash.

Businesses were wary of going to their supply chain to ask for credit and would not tend to consider supermarket banks. There was some usage of overseas banks, private banks and specialists - such as Triodos and Aldermore - but generally business owners either did not know enough about the alternatives or doubted that they would be able to lend the amount needed by the business, particularly at a competitive rate.

Alternative Finance

Overall, the main high street banks continue to enjoy considerable advantages over alternative lenders, particularly in terms of the cost of supplying the service and brand awareness. Although there is a level of distrust of the banks, if these organisations offer an alternative product it is seen as more acceptable than products that are provided by specialist product providers. Bank managers remain a frequently used advisor for alternative finance products. This is coupled with evidence that new players in the market are tarnished by the actions of established financial providers. This is frustrating as there is evidence that

crowdsourced funding and micro finance provided through merchant services can provide good financial solutions when used appropriately. Around 1 in 5 businesses were positive about crowdsourced funding suggesting that it could offer a good solution to the needs of businesses, particularly those who are considered high risk by default (e.g. the entertainments industry). A further 1 in 10 wanted to see how it would develop in the next few years.

Niche products such as micro finance on credit card receipts would be considered by some businesses but there are questions about the time and ability or confidence of the owner to do the background research. In general, such products are useful for some businesses, as part of a wider range of funding sources.

Businesses are generally positive about leasing and hire purchase, recognising the cash flow benefits of spreading costs over the lifetime of an investment. Factoring and invoice discounting are still seen by many as an expensive solution to cash flow issues.

Overall, businesses' preferences were for:

1. Overdrafts (57%)
2. Credit cards (43%)
3. Leasing and hire purchase (30%)
4. Cutting personal consumption/business loans (20%)

Recommendations

- A government-led drive to increase business awareness of alternative finance products and their appropriate usage. A guide to alternative finance can be circulated online through Business Link and other trusted advisors such as the Forum, as well as made available in bank branches or offered to businesses that are refused credit the main lenders. Keeping accountants up to date with market changes is also important as these are the key stakeholders for advice on alternative providers.
- Help providers of niche financial products to gain the critical mass that is required for sustainable lending in the future by considering tax incentives for investors wanting to support such schemes, or making it easier for lending through the payroll. With support, these sectors can gain further credibility in the marketplace.
- Open up the Enterprise Incentive Scheme (EIS) to alternative lenders who wish to lend to small businesses or a new scheme should be introduced to encourage individuals to provide debt finance directly to small businesses which wish to grow. Proof of acceptance as a provider must however be robust to ensure that the market can have faith in such providers.
- Extend the Enterprise Finance Guarantee scheme to cover asset finance (leasing and hire purchase).
- It is clear from our polling that businesses are feeling the bite of increasing cost pressures. The Government must ensure that all that can be done is done to mitigate the rise of business costs.
- On late payment, businesses felt the most successful way of getting paid on time was through making personal contact with their customer. Getting HMRC, councils and utility companies to provide more reasonable payment terms in their demands and be a little more customer friendly would also be useful.
- Only offer government contracts to businesses who have signed up to the prompt payment code and support a strict enforcement code from the Institute of Credit Management.
- Push for the implementation of the EU directive on payment within 30 days to be fast tracked so that it is incorporated across Europe earlier than 2013.

Financial concerns of businesses

“Our company is well funded so access to money is not an issue, but every week we become aware of another ‘sneak’ hidden cost.” Panel member comment

For most businesses - 55% - the main financial issue are the rising costs for the business. A further quarter stated that late payment and other cash flow issues were the primary concern. Research by the Forum (Referendum 197) indicates that the two are very closely linked, as businesses are reluctant to increase their prices to cover their costs and in fact 3% are having financial problems as a result of cutting the costs of their services. To put the figures in context, the latest Annual Small Business Survey from 2010 stated that 19% of businesses considered late payment to be a big problem for the business.

“Increase in fuel costs together with the increased prices of raw materials are a big concern at present. In order to remain competitive, we are unable to pass these increases on to our clients”. Panel member comment

“Customers are taking longer to pay and bad debts are increasing” Panel member comment

17% felt that finance was the biggest issue, either because of cost, access issues or lack of choice. Businesses tend to still have funds available to them but if the company is perceived as being in a high risk category (e.g. hotels, construction) then the cost of that finance (fixed fees, interest rates and other charges) make it an unattractive proposition; in the words of one member ‘a solution of last resort’.

Figure 1: Main financial concern for businesses at the moment

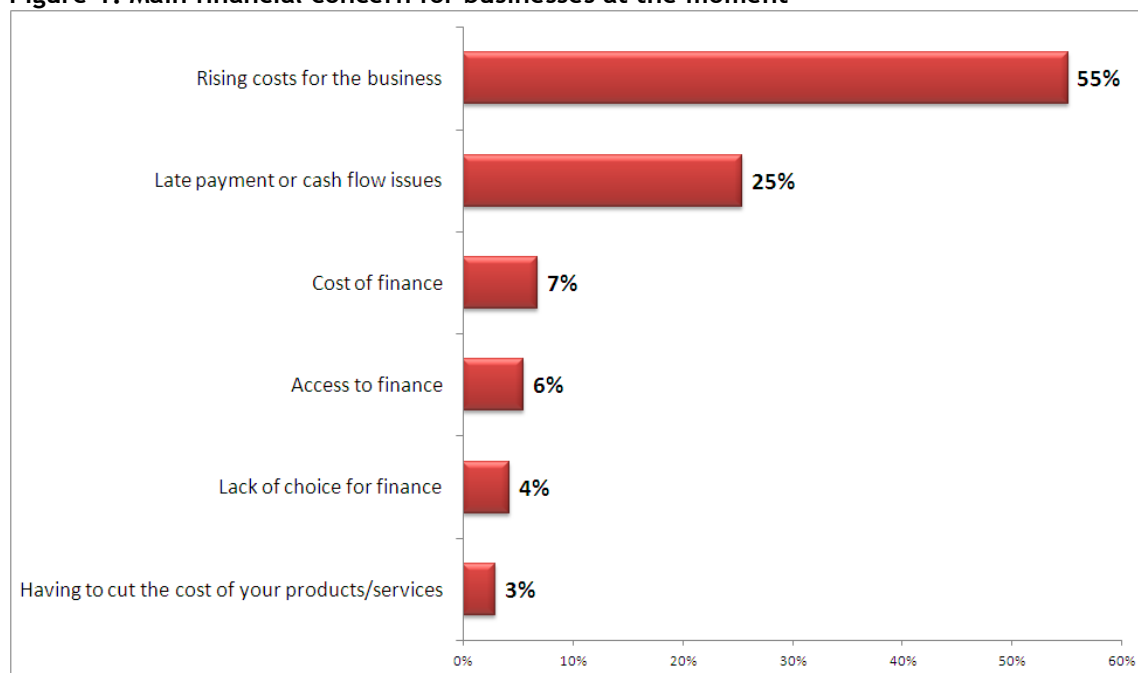
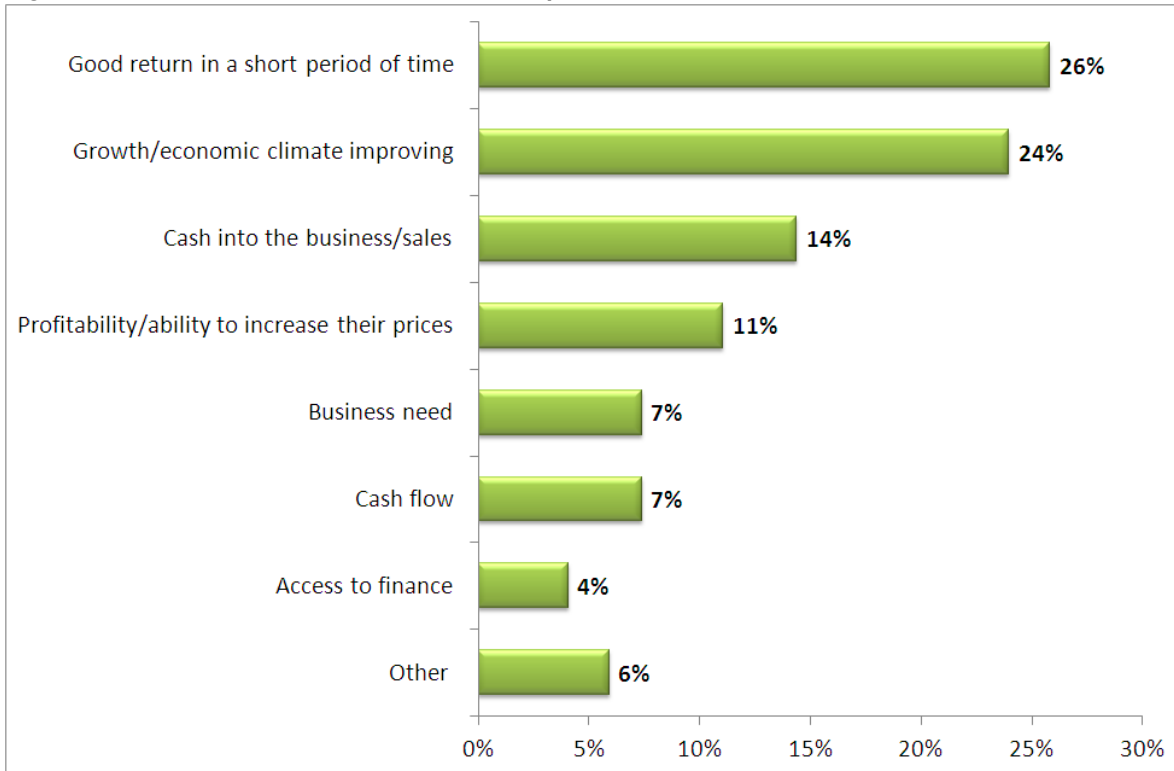


Figure 2 shows that a key concern for businesses when looking to invest is the health of their internal finances with 11% making investment decisions based on the company’s profitability, 14% when there is an increase in cash into the business and 7% when their cash flow allows it. 26% are looking for a good return in a comparatively short period of time, whilst 24% are waiting for the economic climate to improve.

7% would invest if there was a business need and 4% would be prepared to invest if they had better access to finance. Other reasons included time, flexibility of the business, renewed contracts, legal requirements and product development.

Figure 2: What are investment decisions dependent on

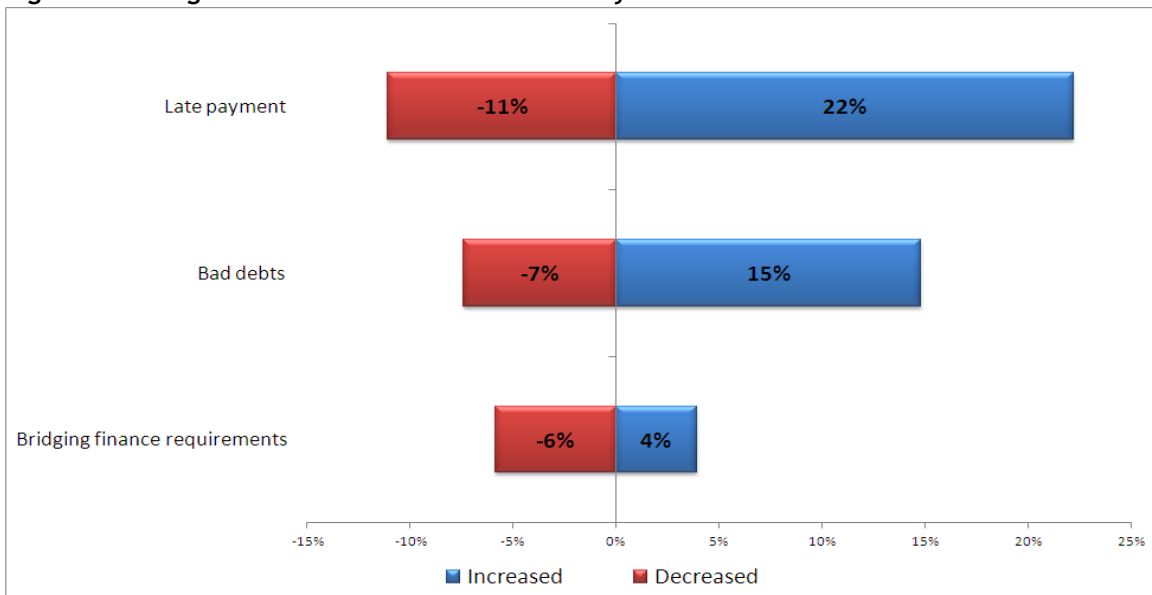


Cash flow

Over the last 6 months a significant minority of businesses have increased the amount of money allocated to late payment and bad debt. Where businesses have reduced the amount allocated in these areas, it is either through the financial pressures caused by the rising costs of doing business, or due to a more thorough credit checking procedure.

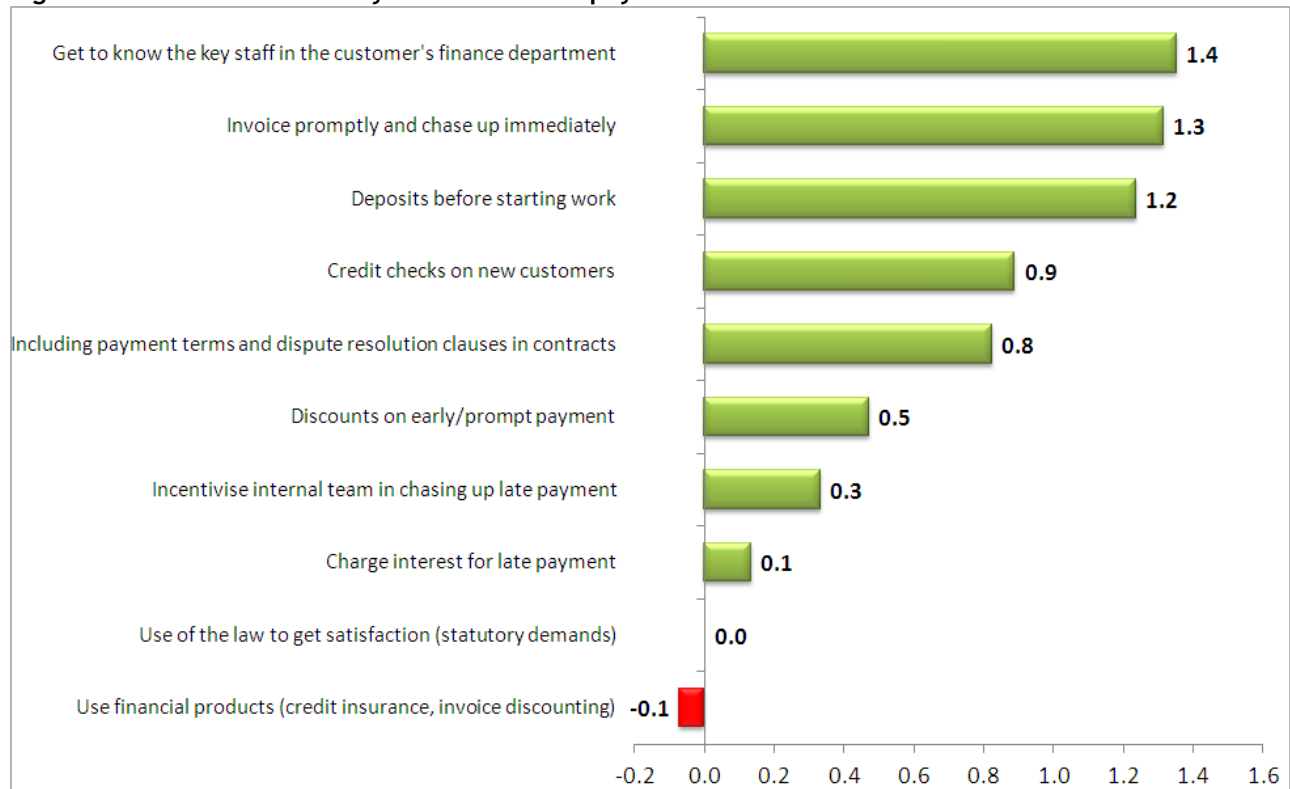
Interestingly there is no increase in the number of businesses who are looking to increase the money required as bridging finance. In fact there is a net reduction in the number of businesses considering short term loans.

Figure 3: Change over the last 6 months in money allocated for...



Panel members were asked to rate schemes in terms of effectiveness using a scale of +2 for very effective, +1 for effective, 0 for ineffective and -1 for counterproductive. A score around 1 gives the impression this is considered an effective way of reducing late payment.

Figure 4: Effectiveness of ways to reduce late payment



The most effective strategies involve a combination of methods employed at different stages of the business process. It was noted that many business owners applied indirect pressure through linking an initial call to the business with customer service, so that the client was aware they were due to be invoiced and had been happy with the work. Invoicing procedures and prompt chasing up were also key, as were deposits before starting work, although in some industries (transport, construction and repair) this was seen as counterproductive. Credit checks on new customers together with clarification of contracts prior to work commencing were both also seen as useful.

For some respondents certain processes were too formal for their industry and legal solutions - such as charging interest on late payment - were generally seen as ineffective. The perceived importance of the personal touch may also explain why financial products are seen as ineffective in this survey, although the withdrawal of credit insurance from a lot of smaller firms in 2008/9 and the pushing of business owners towards invoice finance when it is not appropriate may also have an impact. Financial products are also more expensive than credit checks or chasing up late payers.

“We have been advised by our bank, overdrafts may be cut next year to 5% of turnover. If this action is taken our business cannot continue, due to late payment we require the overdraft we have at present.”
Panel member comment

“If payment for services and products were mandatory then credit issues would diminish quickly. (It would also identify poorly capitalised or un-profitable companies).”
Panel member comment

Despite the perceived ineffectiveness of legal remedies to late payment most of the suggestions for immediate action were to bring forward the EU late payment directive, which will introduce mandatory payment terms for all companies, and bar companies with poor payment records from accessing government contracts. Penalising ‘phoenix’ companies bought back by the same owners would also help businesses maintain more effective cash flow systems.

“There has been recent surge in companies going into administration/liquidation/entering into voluntary arrangements. Some of these companies have actually set up other companies, with the same directors, doing the same type of work and appear to seamlessly transfer work over into the newly set-up

companies. Government should be more proactive with these directors in not allowing this to happen.”
Panel member comment

Around a third of companies reported no issues at all and some even reported that they were completely self-financing.

Alternative Finance Providers

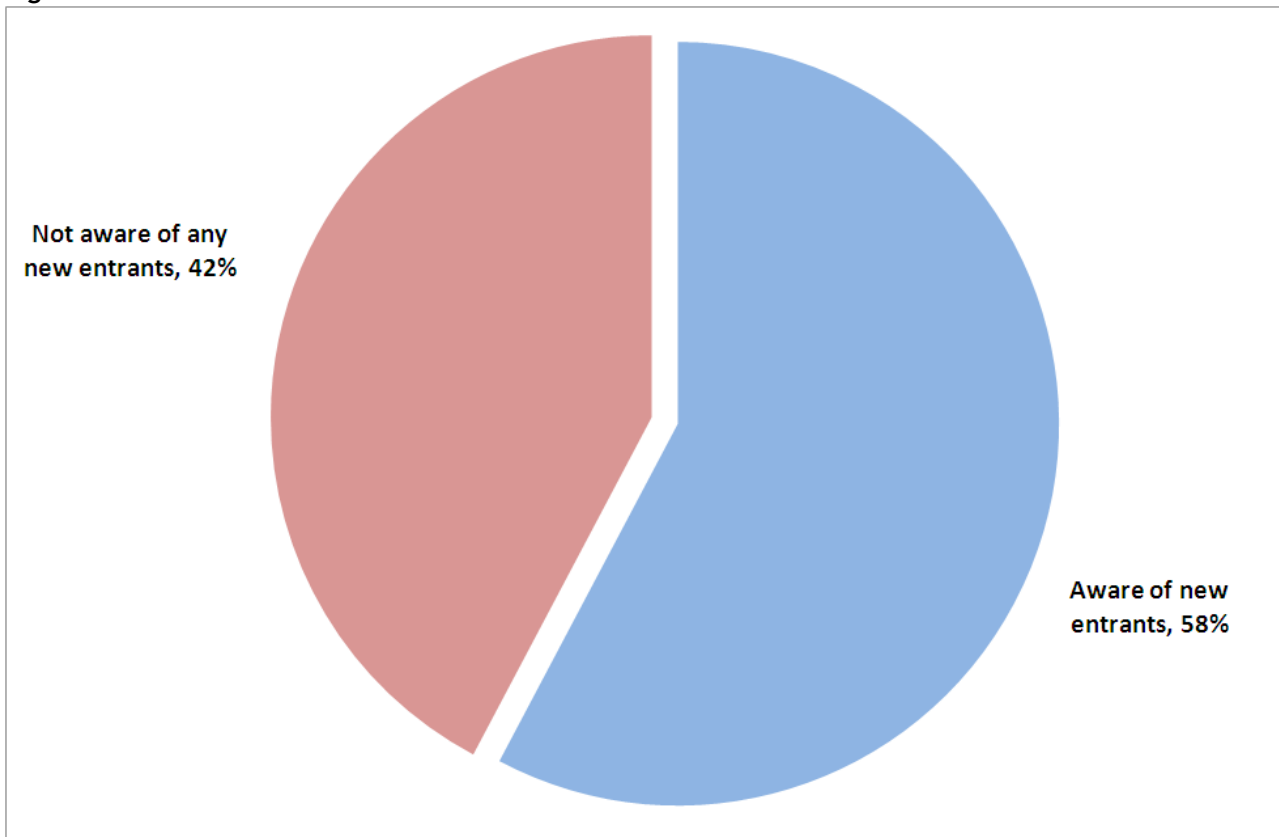
“I will always look for better banking deals.” Panel member comment

24% of respondents wanted greater choice in the provision of 'traditional' banking products (loans, overdrafts etc) and 21% would be interested in accessing alternative products from outside the main high street banks. The main reasons for the desire for greater choice was to avoid having all their financial products in one place and to drive down the differential between the commercial rate of lending and the Bank of England base rate.

There appears to be high awareness of some new entrants due to the high profile advertising campaigns, Santander and Metro Bank were mentioned. Other national providers mentioned Aldermore and Funding Circle (the latter has been promoted by the Forum) and ethical banking organisations. Whether Santander and Aldermore could be considered new entrants, as they have their UK base on more established financial institutions (Abbey National/Alliance and Leicester and the Ruffler bank respectively), is a point of debate although in both cases their business offering has changed with the new branding.

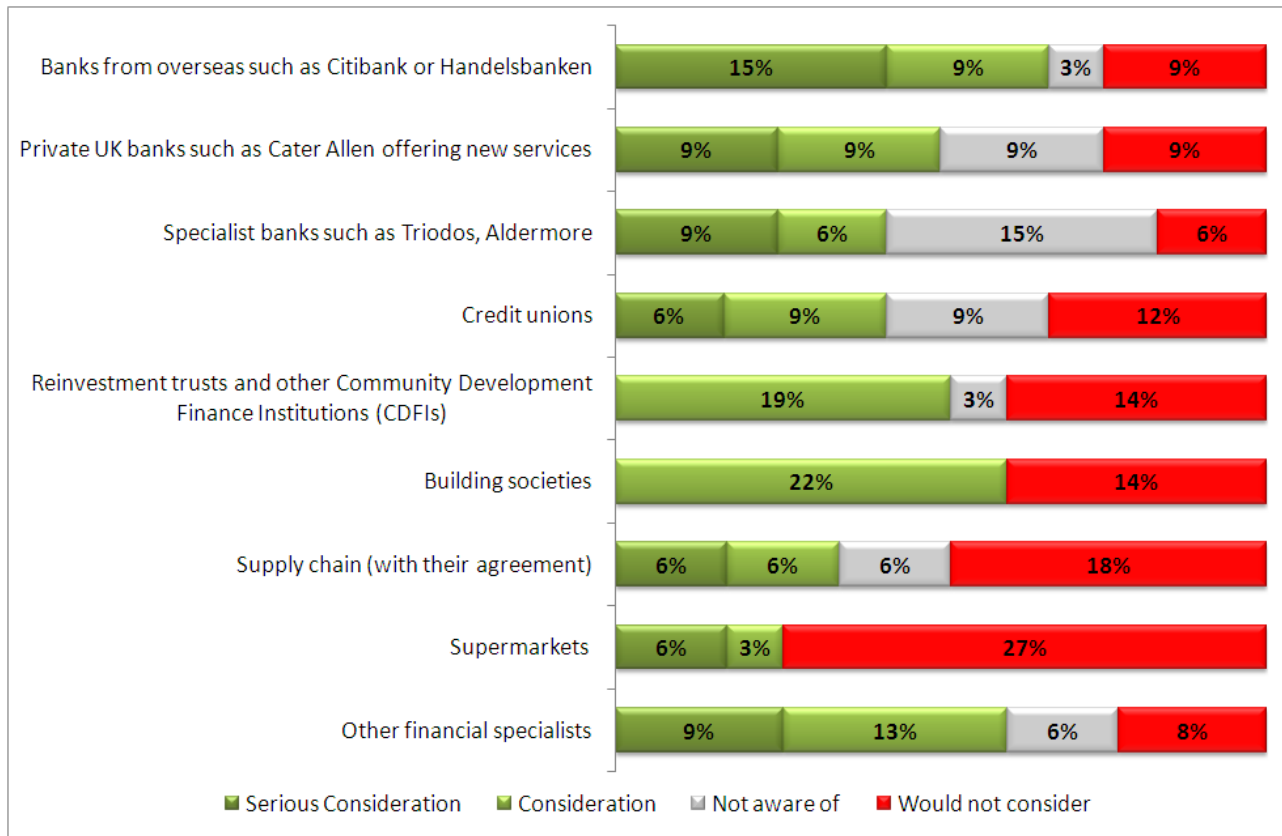
Other more regional organisations that were mentioned were the Black Country Enterprise Loan Fund and the bank established by Essex Council (which was operated by Santander). The web-based intermediary Funding Store was also mentioned, albeit by one respondent.

Figure 5: Main awareness of new entrants



42% were not aware of any new entrants, but these businesses tended to be those that had limited, if any need for finance and therefore had limited interest. Those with access to finance issues were most likely to be aware of new entrants and to be interested in their products. Overall, 64% of business owners had no interest in alternative financial providers offering traditional, alternative or innovative forms of finance. For this reason the stacked bar charts in figure 6 are based on 36% not 100%.

Figure 6: Which types of alternative provider would panel members consider



The highest awareness of new entrants among businesses were supermarket banks and building societies but these organisations (along with the supply chain) were also most readily discounted by panel members. Both were seen as not being able to provide a business specific service. Instead, awareness was raised through their other services, such as retail outlets. In contrast, panel members were least likely to be aware of specialist banks, private banks or credit unions.

“There are some very good niche suppliers out there and companies such as the Credit Union etc are a bit expensive but can help smaller businesses with unforeseen issues such as a supplier demanding payment without giving warning.” Panel member comment

“We have no knowledge of most companies listed, we found credit unions offer better interest than high street banks” Panel member comment

Even where there was awareness of alternative providers, businesses had different experiences of some of them, indicating that, like the main high street banks, it is important to shop around.

The most likely alternative providers to be considered by panel members were foreign banking institutions which established themselves in the UK, such as Handelsbanken. The continuing preference for bank finance (private, overseas or specialist) is due to the fact that they are perceived as geared up to provide a service because of their own, healthy cash flow. Some members also felt they could provide a better assessment of risk than some other providers; this was particularly an issue with the supply chain as there were perceived to be issues with future dealings if credit was sought.

“Spreading the risk, and taking advantage of the best rates available.” Panel member comment

Whilst some providers were felt to be too expensive and to be considered only as a last resort other panel members welcomed the increase in competition in the banking sector. Some felt that new providers from overseas would not have the liabilities of UK banks and therefore be able to drive down costs.

The biggest concerns were over security, the ability of new entrants to the market to assess risk and for regulators to assess whether the financial provider was taking excessive risks. Understanding how lenders

assess risk and determine rates is often hard for a business and there was felt to be little information on them.

“Very little information on them - how long it takes to access finance, what information is required, cost of credit, speed of reaction etc” Panel member comment

The lack of information is important in distinguishing products of new entrants from the existing main banks, which are seen to provide a similar service. It is also relatively easy to find out about lending rates from main bank branch networks and so the proximity of branches are a big issue for businesses who required cash handling services. For this reason when a business owner is aggrieved at the service provided by one of the main high street banks the solution tends to be to consider one of the others, even though they are considered broadly comparable.

“Used to be a personal relationship with high street banks, but they still have a place especially if you have been dealing with the same bank for years.” Panel member comment

Other members of the panel felt that the service from their current banking providers was adequate or relatively good. Though there were some concerns over savings’ rates and customer service, neither was considered a compelling reason to consider alternative providers.

Alternative Finance Products

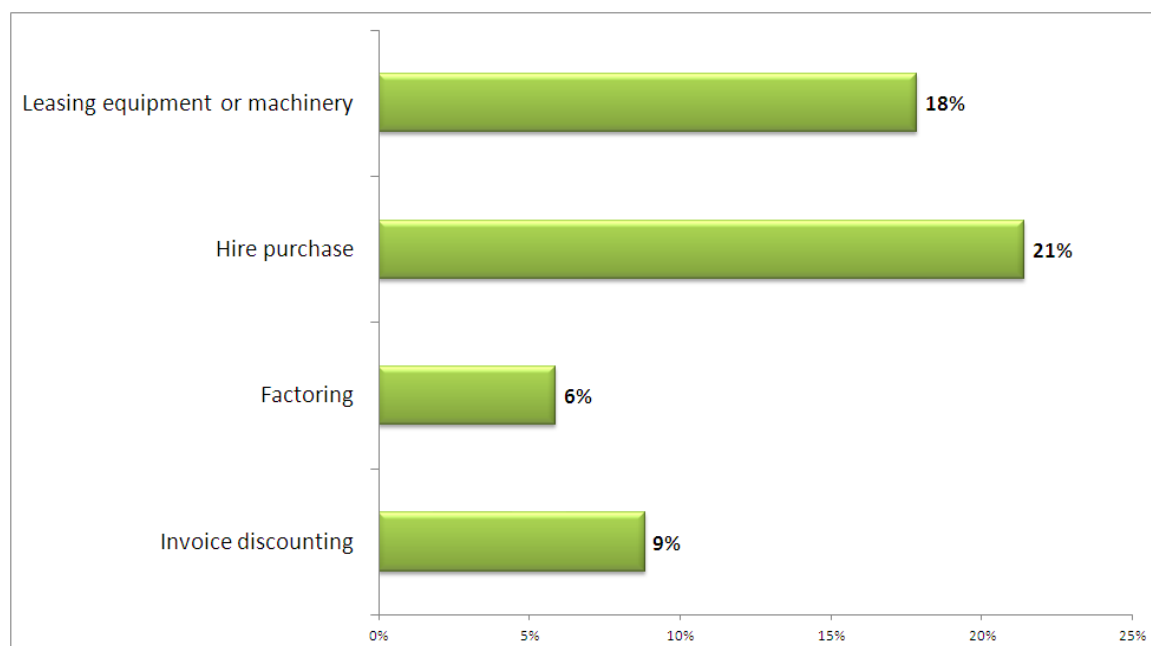
21% would be interested in accessing alternative products from outside the main high street banks, with 7% interested in alternative financial products from the main high street banks. 4% were interested in innovative financial formats. Those members who reported access to finance issues were the ones most likely to consider alternative financial products.

Asset and asset-based finance

“HP [Hire Purchase] from bank was reasonably priced” Panel member comment

26% of members showed some interest in alternative financial products and almost all those who would consider alternative financial products already had some form of asset-based finance. 21% used hire purchase agreements, 18% leased equipment or machinery, 6% used factoring and 9% used invoice discounting.

Figure 7: Usage of alternative financial products



“Match the funding to the life of the asset makes sense, you spread the cost of ownership across the life of the asset so helps working capital.” Panel member comment

“Hire purchase and leasing can be a very effective way of investing and if you shop around it can be cheaper than a loan.” Panel member comment

The main advantage suggested by businesses using asset finance, invoice discounting and factoring services was that they eased cash flow. Generally, panel members that used hire purchase and leasing methods were positive about those methods. In some cases asset-based lending was considered to be cheaper than a loan, however there was a caveat about comparing advertised rates with those of loans because of the ownership of the asset.

The downsides of asset finance included cost, a lack of flexibility and the true worth of an asset (particularly if it fails, has to be sold quickly or is considered an illiquid asset). The concern is simply that the lender/owner determines the value of the asset often to the detriment of the borrower.

“How valuable are the assets in a ‘firesale’ scenario?” Panel member comment

Negative comments about invoice discounting and factoring centred on cost and inflexibility of products. For factoring, there was a particular concern over a loss of control of an aspect of the business and there was also concern about the collateral demanded from the owner together with the time taken to draw down the money that has been paid. Some business owners felt that the information required was also excessive.

New entrants such as Market Invoice and web-based intermediaries like Funding Store may reduce some of these negative perceptions over time. However, it is clear from members’ experiences that one or two banks are moving businesses from overdrafts and loans towards invoice finance when this is neither appropriate nor wanted by business owners. This is damaging the reputation of the products.

In general however 38% of businesses felt that the credit crunch had made asset-based finance more attractive.

Crowdsourced funding/crowdsourcing

Panel members were asked about crowdsourced funding with the examples given of Crowdcube (where start-up businesses offer equity in return for finance), Funding Circle (which provides lending to established businesses and has been promoted by the Forum) and Zopa (which is perhaps the best known example, albeit from the consumer sector). The examples do illustrate the broad range of funding available through such a concept.

Around 1 in 5 businesses were positive about crowdsourced funding suggesting that it could offer a good solution to the needs of businesses and 1 in 10 wanted to see how it would develop in the next few years.

“It seems like an innovative idea, and I think for something people feel passionate about it could work very well.” Panel member comment

Some respondents felt that this was a good idea for niche industries where people could follow their interests and provide financing for projects and companies that would otherwise not get off the ground. There was a difference of opinion on how much information would need to be provided in terms of financial history or detail on the actual product or service.

“It is a great alternative if you can't raise funding any other way, especially for higher risk/reward projects such as in the entertainment industry.” Panel member comment

Crowdsourced funding was seen as an option for businesses that were not able to access finance through traditional revenue schemes as well as an option for growth, with some members expressing concern that traditional lenders were still too conservative in providing funds to help businesses grow.

Others were interested whether schemes could potentially allow individuals to drive down the cost of lending in investing in British businesses, circumventing the banks or because it could offer better financial returns than leaving the money in the bank. One person indicated that if there was a way of accessing such a scheme for ordinary employees akin to the payroll giving for charities then this may be a further way of providing lending to UK businesses.

“Sounds very risky. What happens in a major recession when everyone wants their money back at once?”
Panel member comment

One or two members indicated that the system was ‘flaky’ with long-term concerns about whether the lenders in the market could survive, particularly if mainstream providers started to replicate the service. Others simply stated the scheme was “rubbish,” concerned that the opportunity for fraud was considerable. The lower start up costs of an internet financial service (compared to one underpinned by a network of branches) meant that there were also concerns about the variation in financial processes put in place to avoid systemic failure.

“Expensive and potentially unreliable.” **Panel member comment**

Alternative providers have been keen to use the internet platform to provide transparency by publishing the lending rates (Funding Circle is around 8.4%). Zopa and Crowdcube have a similar method of publishing information on lending. Some providers have also put in measures to provide a stand in servicers who will stand in and service loans for the organisation and monitor the secondary market to reassure investors that there is a market if they need to resell. Around half of respondents declined to comment as they felt that they would not consider finance products of any sort or would not consider new forms of finance until they had some track record.

We also asked about the sustainability of crowdsourcing. Currently, such schemes are attractive to businesses due to the difference between the Bank of England base rate (0.5%) and the commercial rate of lending. If the difference returned to around 1% there would be a question over whether the system was viable.

In total 23% felt that the scheme was sustainable and that the cost of finance is unlikely to go back to previous levels and highlighted the advantages to lenders as well as borrowers. One business pointed out that it was not a traditional loan and that it offered a way for businesses and individuals to use their capital so that it is not losing them money in real terms.

“Funding Circle allows lenders to choose the business they lend to based on multiple criteria. I have invested money in Funding Circle and have a preference for lending in my local community.” **Panel member comment**

Others see it as a way of reducing the burden on an overstretched business angel network which had helped some panel members in the past.

19% however felt the scheme was not sustainable, predicting that it would be a “recipe for disaster” and that it would be squeezed out when banks become “less greedy and more competitive”. Some felt that there was opportunity for fraud and were concerned that this could lead to investors losing their money to people who have no intention of setting up a business, or lead to industry specific bubbles e.g. the ‘dot-com crash’.

Over half of respondents - 58% - lacked sufficient understanding to pass comment, in itself an interesting statistic that raises issues of financial awareness.

Micro finance using credit and debit card receipts

Providing finance based on credit card receipts was another niche product that was again treated with some scepticism and was deemed inappropriate for a significant proportion of panel members.

“It would work in retail, as stock is needed in advance of sales which are mainly carried out via card transactions. It would not work so well in the business to business environment as my business takes card payment so infrequently.” **Panel member comment**

There was interest in finance for stock and for growth finance (refurbishments/fit outs or the equipment for new sales), although some businesses felt that this was not something for their sector as the growth or margins were not there.

“Risky in the current climate where work in our industry is diminishing and the sector may take a long time to recover”. **Panel member comment**

There was broad support for the idea from accountants and businesses in the target industries (hotels and restaurants, hairdressers and garden centres) where the individual saw growth opportunities. The flexibility of the product and the time to pay back the borrowing was a particular benefit although one accounting member reported that the banks used to be able to structure a loan so it would take into account seasonal trends. Even a loan of this type could not account for specific issues such as the impact of the weather on takings as this solution takes into account changing turnover in real time.

“Good idea, though I do not know any of the specifics or rates.” Panel member comment

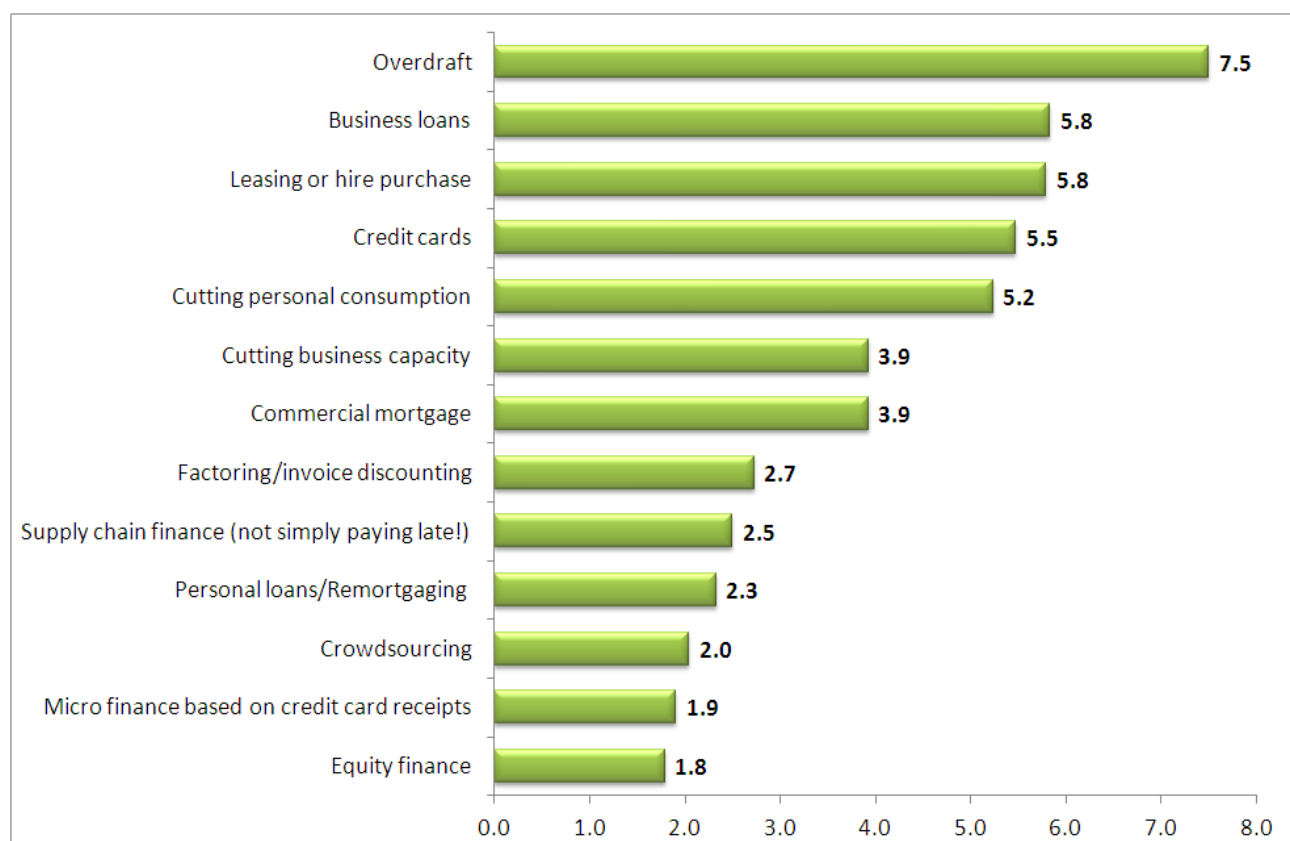
There was however interest in the scheme, with a number of members looking for an idea of the cost of finance (typically providers look for a factor of around 1.3 to 1.4 for each loan depending on the period taken to pay back and the proportion of credit card sales taken). Concern about whether this may limit their choice of merchant services was also mentioned by a travel agent who felt that the company had a good deal on their merchant services.

Traditional lending from the banks

Only one question was specifically asked on why the main high street banks dominated the industry. The answers given by business owners were locality, security, long-standing relationships, cost of finance, the upheaval of changing and the lack of any significant gains to changing.

The main reason is that business owners like and understand the products that are provided through the banks, including ‘alternative’ products such as hire purchase. Businesses also understand products such as credit cards and see them as a solution to short term cash-flow issues.

Figure 8: Priority scoring for financial products



(Products were scored out of 10 with 10 being awarded for those who would consider the product in the first instance, 7.5 for those who would consider if rejected for their first options, 5 for those who would reluctantly consider a product, 2.5 for only as a last resort and 0 for those who would not consider an option under any circumstances)

57% of panel members would look for an overdraft as one of their main preferences for lending, 47% indicated that credit cards were a preferred choice for funding and 30% would consider leasing or hire purchase as a preference. Crowdsourced funding and micro finance funding were very much niche products and were not a preference for panel members. This may change as the economy recovers as both

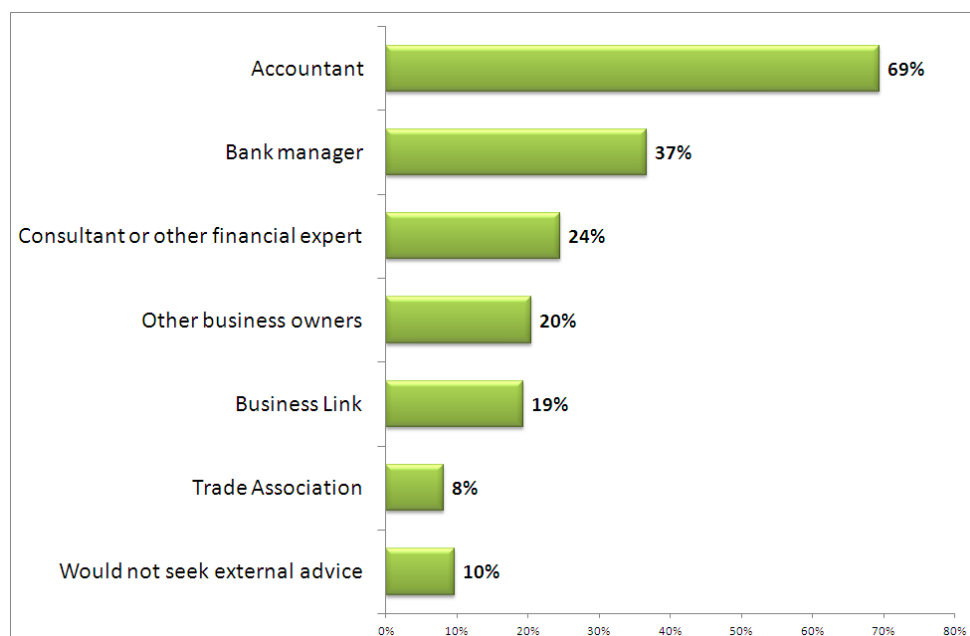
are seen as potential methods of funding growth, although leasing or hire purchase is currently the preferred method with business loans as the back-up option.

Figure 9: Assessment of product preferences

	Priority rating	% stating main preference	% would not consider
Overdraft	7.5	57%	14%
Business loans	5.8	20%	14%
Commercial mortgage	3.9	11%	24%
Factoring/invoice discounting	2.7	16%	36%
Supply chain finance	2.5	6%	29%
Leasing or hire purchase	5.8	30%	14%
Credit cards	5.5	47%	24%
Equity finance	1.8	0%	43%
Crowdsourcing/crowdsourced funding	2.0	0%	41%
Micro finance based on credit card receipts	1.9	0%	48%
Personal loans/Remortgaging	2.3	5%	47%
Cutting personal consumption	5.2	20%	9%
Cutting business capacity	3.9	5%	10%

Although there has been a centralisation of banking and the number of commercial bank managers have been reduced following the last recession, they are still seen as one of the key advisers on alternative finance; figure 10 shows that 37% of respondents stated that they would look to their bank manager for advice on such products. Accountants are the main adviser on alternative finance and 20% would look to testimonials from other business owners.

Figure 10: Where panel members would seek advice on alternative finance



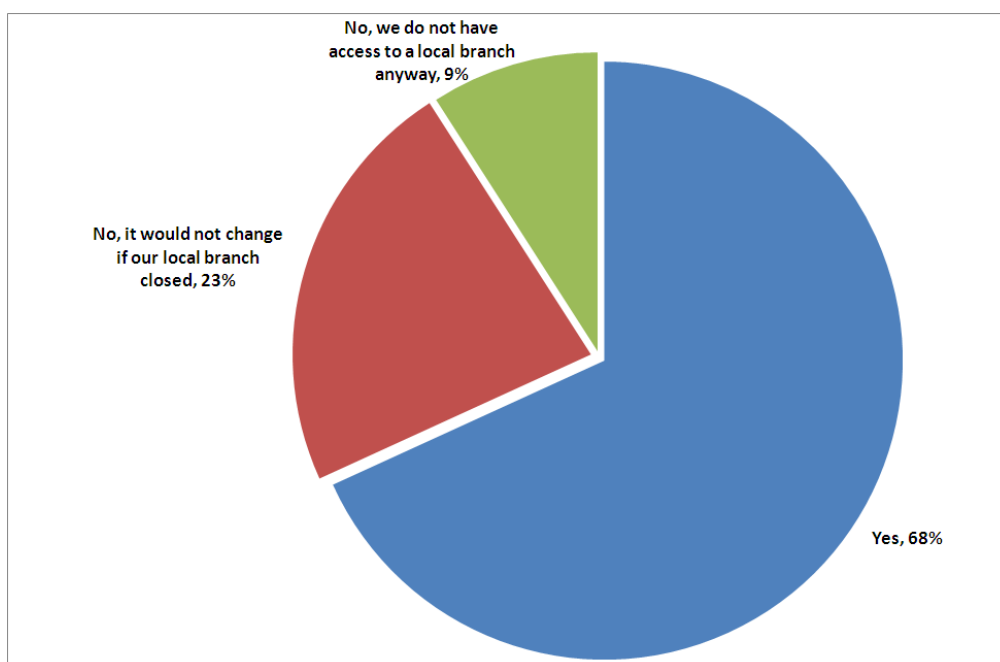
In 2008 the Forum and Graydon asked a similar question about general financial advice. There is no significant difference in terms of bank managers or accountants but businesses do appear less likely to trust trade associations or consultants on the issue. There is greater reliance on Business Link although this may change as the service reduces in the autumn. These changes are outlined in Figure 11.

Figure 11: Comparison of usage of financial advice 2008 and 2011

	Alternative finance	General finance (Graydon 2008)
Bank manager	37%	39%
Accountant	69%	72%
Business Link	19%	12%
Trade association	8%	16%
Consultant or other financial expert	24%	36%
Other business owners	20%	n/a
Would not seek external advice	10%	15%

Branch networks were considered to be an important element for business owners, particularly those who required cash handling services. Panel members also liked the opportunity to meet directly with their bank manager if required. In total, 68% would consider changing banks if their local branch closed - this compares to around 11% who were considering switching banks in 2008 at the height of the credit crunch.

Figure 12: Whether businesses would consider changing banks if their local branch disappeared



In total we can highlight the following disadvantages for alternative providers from this research:

- Cost and scalability, the main suppliers thought to have a cost advantage over most new entrants,
- Branch networks and brand awareness,
- Consumer inertia and time to research providers and the products,
- Information requirements for newer entrants to assess risk,
- Assessment of risks and stability of the organisation,
- Lack of confidence in regulation to protect business owners.

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