



GRAYDON

**Forum of Private Business
and
Graydon UK**

**Research Report
Finance and Credit
Management**

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Introduction

The Forum of Private Business (FPB) is a proactive, not-for-profit organisation, providing comprehensive support, protection and reassurance to small businesses. Graydon is one of the leading credit reference agencies specialising in credit risk management. The two organisations have worked closely together on this research project to better understand the needs of owners of small and medium-sized businesses and identify the key issues for business finance in 2010.

The questionnaire was emailed to 204,000 randomly selected business owners or financial directors in the UK. In total, we received 756 responses; a response rate of 0.4%. 61% of respondents came from micro businesses, 31% from small business employers and 8% from medium-sized businesses.

Summary of findings

These are the main summary of the findings:

- 2009 has been characterised by a constriction of credit supply and significant demands on credit. Banks are now reporting that they are ready to lend, yet there is a reluctance of financiers to loan to businesses looking to expand if they have previously required working capital.
- As 2009 played out, smaller firms simply did not have the assets demanded by lenders which wanted security as part of a policy decision to encourage businesses to have “skin in the game”. This became the major reason why businesses could not get access to the credit they needed.
- All forms of credit became harder to access in 2009 and business owners increasingly turned to personal credit to keep their businesses afloat. This may have some adverse implications when personal bankruptcies increase after Christmas.
- Businesses are looking to reduce costs as a priority, which indicates that the recovery is likely to be slow. It could however mean that it is sustainable.
- Having a good credit rating is already important for businesses looking to access external credit as those with a good credit rating are less likely to be refused.
- Whilst a small proportion of respondents are not concerned about a good credit rating, the majority feel that having a good credit rating will be good for their businesses. To some extent, this has already been proven.
- 31% of respondents would like to know more about how to influence their credit score and a slightly larger proportion are concerned about the increasing onus on businesses to illustrate that they are creditworthy in the current lending climate.
- Businesses have tightened up considerably in terms of financial discipline. Almost half of respondents monitor their supply chain in some form and the majority of these use the credit rating to help define the terms that are negotiated. Others have focussed on cutting costs further. Nevertheless 20% of businesses still feel that cash flow/credit control is a key issue for them.

How businesses can improve their access to finance

As an expert in credit rating, Graydon UK suggests the following solutions to some of the key issues highlighted in this research. Credit rating has become even more important in the recent economic climate, when access to finance is much harder for most businesses. Businesses now need to work hard on influencing their credit rating if they wish to improve their access to finance.

The state of a firm's credit rating could make a big difference to the credit deals it can get from banks and suppliers, yet many businesses are unaware of how poor that record may be.

Credit agencies typically consider three key factors:

- A calculation of long-term solvency, for example, how much equity is in the business and whether shareholders reinvest profits
- Short-term liquidity, which covers what is going in and out of the business in terms of costs and income, known as cash flow
- Profitability.

According to Graydon, the most common reason why businesses have a poor rating is because they fail to share details about their firm.

There are slight differences according to the type of business. Incorporated firms or partnerships are judged on different criteria from a private limited company, because the principal(s) are personally liable. So, in most cases, a successful trading track record and good supplier relationships will yield the credit required. Certainly, for unincorporated businesses, the more information that credit agencies have, the more comprehensive the credit rating will be; they can only derive a meaningful credit rating on information received and validated by their databases.

For companies with limited liability, another set of guidelines apply. Here, the creditor is making a judgement on the viability of a separate legal entity. Usually, they use as much information as is publicly available and, most of the time, they get this information from a recognised credit reference agency.

Ways to improve the credit rating of a business

1. Maintain a trading track record. Firms and partnerships are judged on different criteria from a private limited company because the principal(s) are personally liable. So, in most cases, a successful trading track record and good supplier relationships will yield the credit required.

2. Provide detailed information. For unincorporated businesses, the more information that credit agencies have, the more comprehensive the credit rating will be. Often, the lack of information can have a negative impact on your business's credit rating. Do not hesitate to contact your credit reference agency and disclose to them information that can improve your credit rating – for example, management or interim accounts, trading information – as that can improve your credit rating. Services such as CreditPal (www.creditpal-online.com), a new, free, online service, allows SMEs to easily share financial information with their customers and suppliers, which can help businesses to produce an up-to-date credit report and therefore influence their own credit rating.

3. Invest time in the validation process. A credit reference agency will be undertaking the enquiry on behalf of their clients and they are seeking to validate your credit terms. Information such as the nature of the business and VAT registration numbers form part of this process.

4. Keep your filing up to date. Don't delay in recording changes of directorship and keep within the statutory filing requirement dates, seven months for a public limited company or ten months for private limited businesses, from your financial year-end.

5. Determine your net worth. This is the sum of the issued share capital and the profit and loss account. Negative net worth is a hazard to ratings and movements will affect your credit rating. File profit and loss accounts, so that any downward movements in the net worth can be seen to be drawings or losses. The natural assumption is that negative impact on the net worth of a company is due to losses, if there are no other explanations.

6. Retain profit in your business. This will increase your net worth each year and shows that more is being retained and invested in the business, which gives a favourable prospect for a good credit rating.

7. Review your share capital. How much credit would you offer to a company where the

shareholders are only prepared to put two £1 shares at risk? Have you, as a director or shareholder, loaned the company money which you have no intention of redeeming? Consider capitalising the loan, this will increase the net worth and most likely will have a positive impact on the credit rating.

8. Record borrowing terms accurately. Remember that your supplier is interested in ascertaining whether your company can repay them. Bank loans, other than the portion falling for payment inside one year, which are included in overdraft values, will have an effect on the working capital position. Working capital is a measure of cash flow, so it follows that negative working capital (where current liabilities exceed current assets) will be taken into consideration for a credit rating.

9. Maintain good trading relationships. Pay suppliers within agreed terms – in today's economic environment more and more trade payment data is used by credit agents as a guide to current credit worthiness.

10. Avoid negative information. County Court Judgements, Decrees, petitions for winding up – no matter what the outcome – will have an impact on your rating. With the current market conditions and in the prevailing 'rescue culture', there are more avenues for mediation than ever before. It is correspondingly interpreted as a sign of financial stress when a small company incurs a series of County Court Judgements.

11. Be objective. Consider for a moment, exactly what information is available. The creditor needs to be able to judge whether they will eventually get their money and they look at various pieces of information upon which to make this judgement, including, but not exclusively, a credit reference agency report. Credit policies are not set by credit reference agencies; they are set and run by the individual supplier. When credit is key to a transaction, enter into a dialogue with your supplier to enable them to have as much data as possible, in order for them to make an informed decision.

It is equally important to monitor the financial stability of an existing supplier or to see what credit rating was given to a new customer's business. Whether you do business in the UK or internationally, you need to reduce your exposure to risk and ensure that your business relationships are profitable.

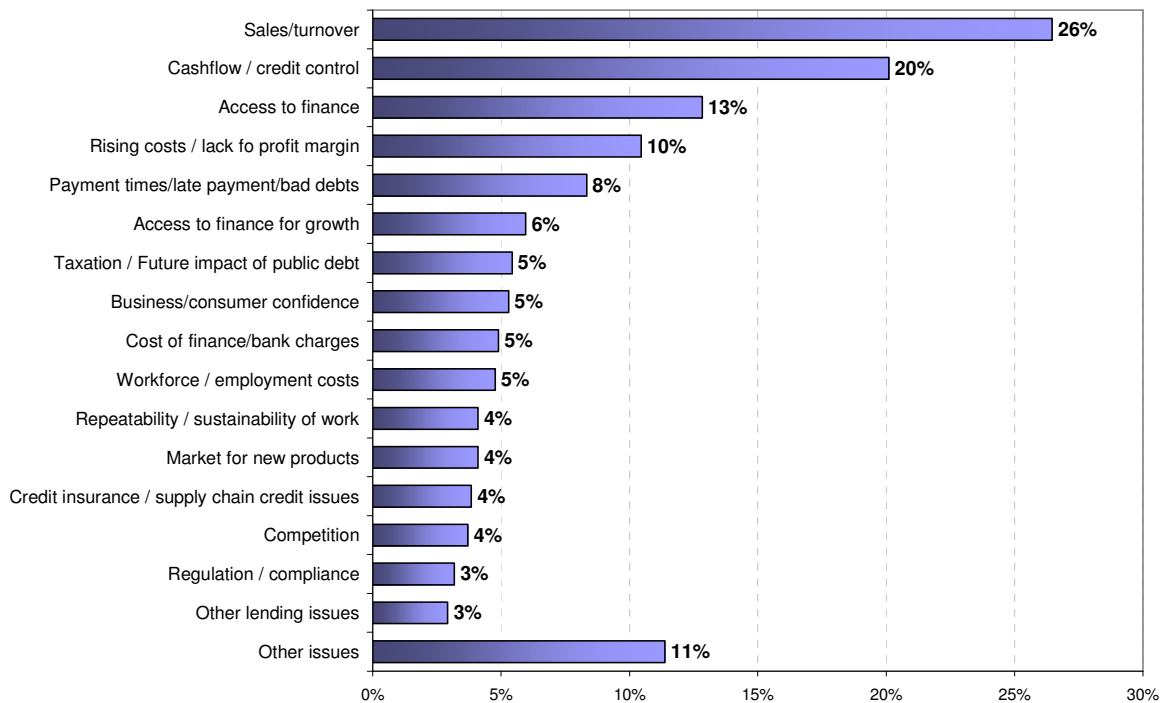
Current issues for businesses

Lack of sales or turnover is the key issue for businesses, particularly as the recession continues. This has had an impact on other issues such as access to finance and its cost. 20% have cash flow issues, with a further 6% having problems with late payments and 2% citing bad debts.

19% of respondents listed access to finance making it the third main issue, with 6% citing access to finance to help their businesses grow and 13% access to finance generally. A small proportion (particularly estate agents and retailers selling high ticket items believed that banks were simply not lending to them.

Rising costs and the lack profits is also a problem, with utility costs and employment or workforce costs being mentioned specifically.

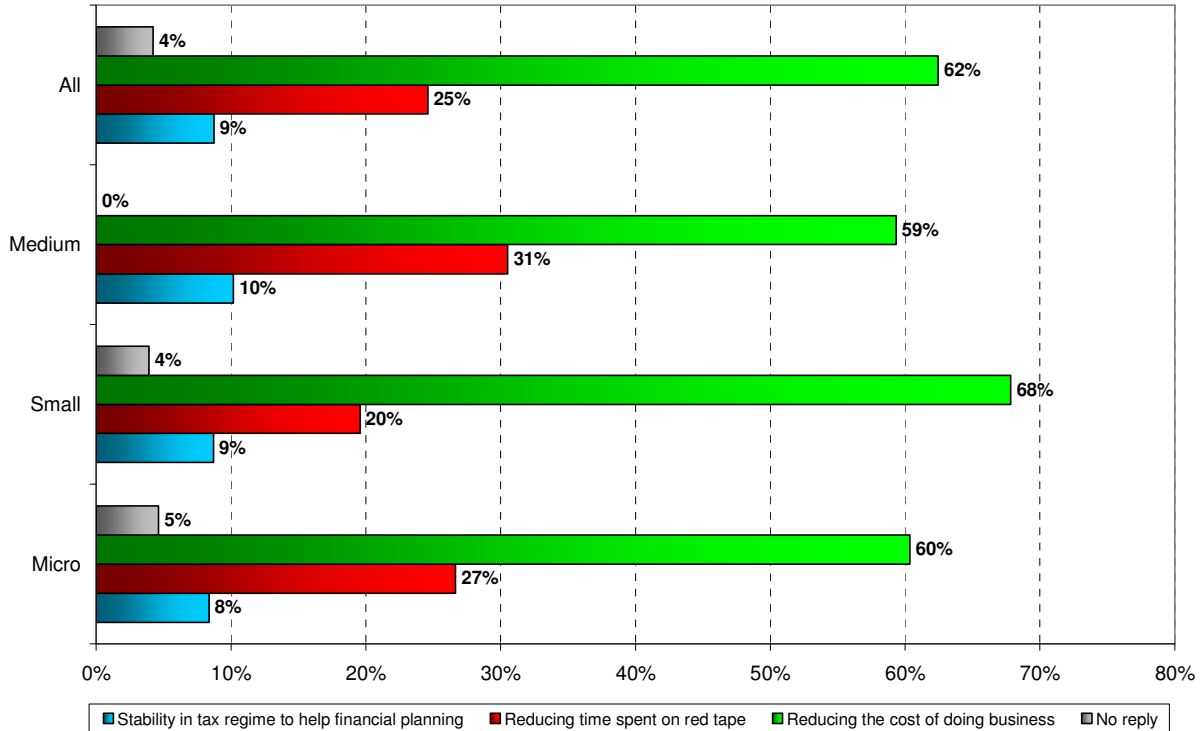
Figure 1: Current issues for businesses



Priorities for businesses

62% of respondents are looking to reduce further the cost of doing business. This may inhibit investment in the short term; however, the cash flow problems experienced when companies gear up to deliver orders after a recession caused more insolvencies in the 1990s than the recession itself.

Figure 2: Priority for business



Businesses with between 10 and 49 employees are most likely to prioritise reducing the cost of doing business rather than focusing on red tape or taxation issues, whereas almost a third of medium-sized businesses cited this as a priority. This may be because businesses employing more than 50 employees have more opportunity to reduce the time spent on red tape whilst the micro business employers (those with fewer than 10 employees) have time issues exacerbated by having to chase late payment. There are indications that the recession has hit businesses with 10 to 49 employees particularly hard and this may have caused a more defensive attitude amongst such businesses.

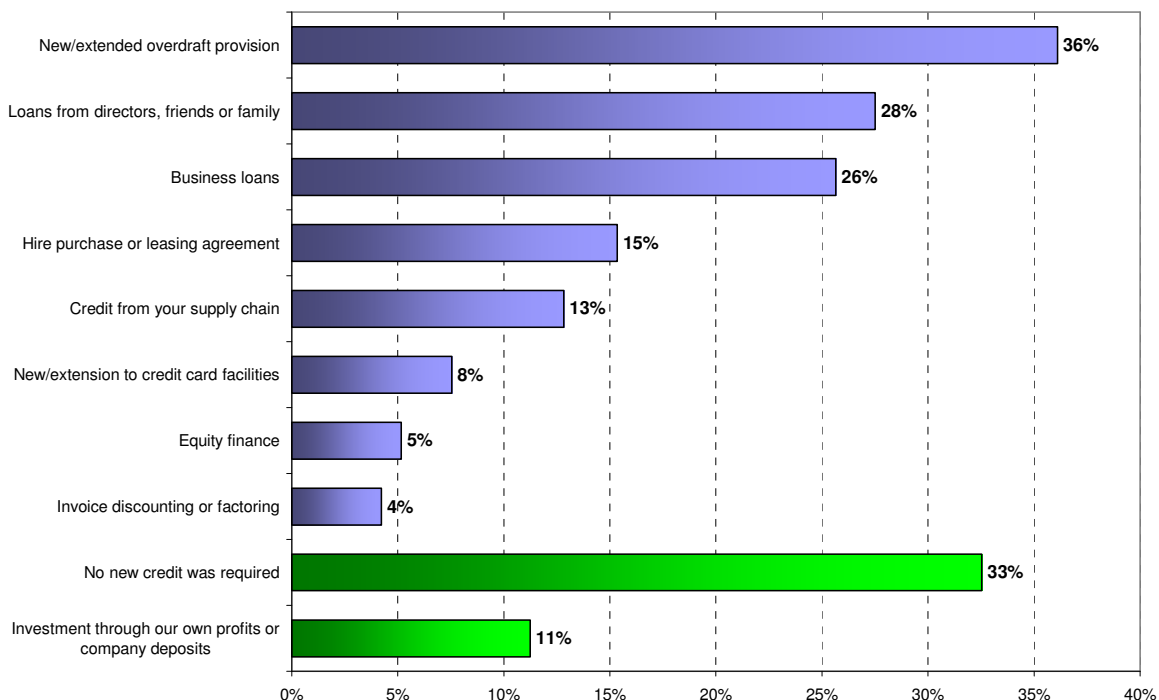
Unsurprisingly, with the VAT changes in 2009 and 2010, retailers are most likely to want a stable tax regime, as are those who have invested in new machinery or systems. Those in the East Midlands and public sector facing organisations were most likely to prioritise red tape rationalisation.

Sources of credit

38% of respondents did not need or had not applied for any funding over the last six months, with 11% financing their businesses through their own profits/deposits. 33% did not need additional credit during this time period. Around half of those that were financing their businesses through their own profits were doing so because of an inability to get finance.

After new or extended overdrafts, the next most frequently considered source of income was personal loans from directors, family or family. Business loans, which form the majority of the small business lending stocks from banks, were only sought by 26% of businesses. The larger the amount requested, the more likely that a number of options were considered, with, typically, personal loans and credit cards used to top up other forms of finance.

Figure 3: Sources of credit



How much capital businesses will require

Micro, small and medium-sized business employers were, on average, looking for almost £61,000, although this varies depending on the size of the business. This would indicate demand amongst small and medium-sized business employers alone (excluding sole traders) would have been £56.8 billion, or marginally higher than the total lending stocks for small businesses – £55.6 billion⁽¹⁾. Not all this amount was required from banks, with higher capital requirements (£100,000 or more) requiring a significant element of venture capital funding.

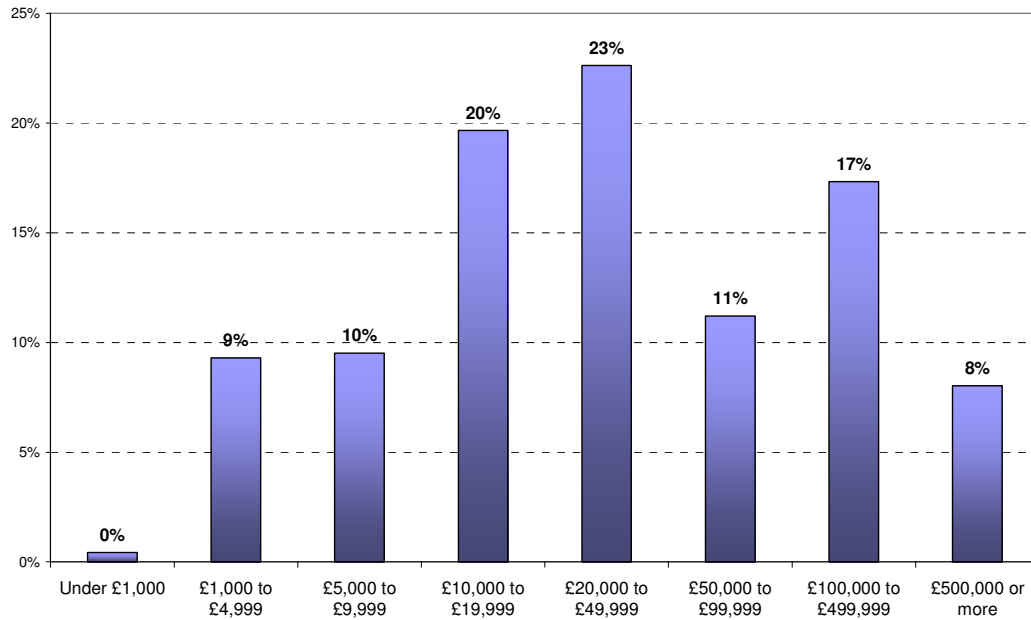
Figure 4: Average amount of capital required

| | Mean amount required by firms seeking credit | Median amount required by firms seeking credit | Mean amount of lending required by all firms |
|-------------------|----------------------------------------------|------------------------------------------------|----------------------------------------------|
| All businesses | £97,508 | £46,915 | £60,666 |
| Micro businesses | £64,388 | £19,522 | £37,285 |
| Small businesses | £112,469 | £49,999 | £77,750 |
| Medium businesses | £277,895 | £192,857 | £185,263 |

As suggested by the difference between mean and median, there is a significant spread of lending required. This is predominantly based on the size of the business; however, two years of recession in the construction industry and related issues (such as the seasonal demand for the new build and cut throat competition) has meant that companies in this sector applied for more finance than other sectors.

Companies in London, Yorkshire and Humberside and the North West were most likely to require larger sums of money; however, this was also related to the greater focus on investment rather than structural problems.

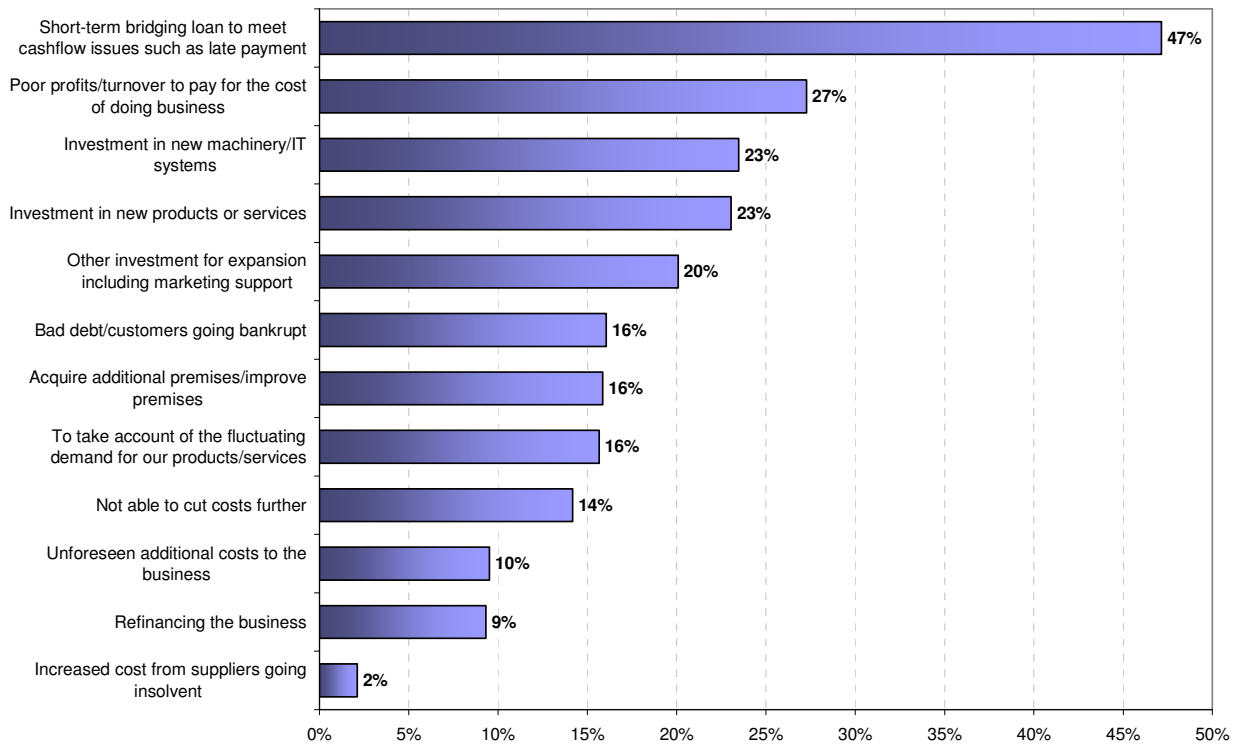
Figure 5: Total amount of credit required



Reasons for seeking credit

Over the last six months, businesses had more than one reason for looking for credit, with 43% looking for money for additional investment as well as working capital in the form of bridging loans or to meet cash flow issues caused by the current economic climate. Around 28% of respondents were looking for finance for further investment to take advantages of opportunities in the marketplace and a similar proportion were looking to finance to deal with working capital issues only.

Figure 6: Sources of credit



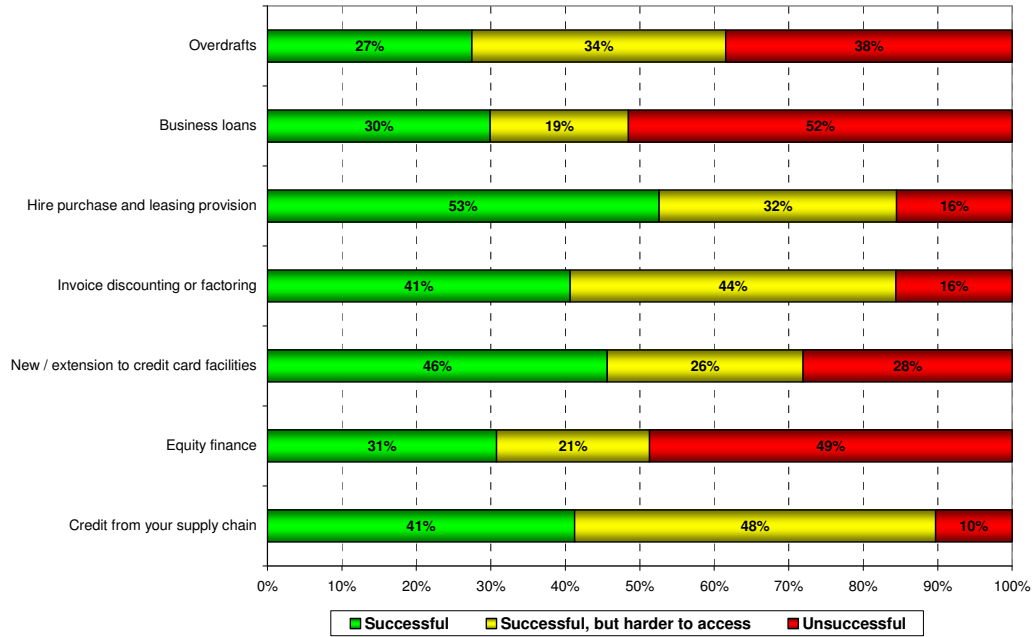
Success in accessing credit

In total, 40% of those looking for credit (almost a quarter of the sample) in 2009 were unsuccessful in accessing one or more types of finance. Access, in terms of traditional commercial finance from banks (loans and finance), was particularly low, with 52% being refused for business loans and 38% being refused an extension or additional overdraft facility. The most recent research on this subject, the latest BIS SME Business Barometer⁽²⁾, puts the success rates for all types of finance at 42%, overall the comparative figure from this research is 40%.

Credit rating was an important determining factor: 44% of those with a good credit rating were refused a loan compared to 55% of those whose credit was average or poor and 62% who did not know their credit rating.

In terms of loans, 23% of those with a good credit rating had had an overdraft extension or new facility set up, compared to 51% of those who had an average or poor credit rating or did not know their credit rating.

Figure 7: Success in getting credit



The last major government sponsored study on finance, undertaken by CBR⁽³⁾ in 2007. The study asked about the companies need over for credit in the three years to 2007, in contrast the FPB/Graydon research looks at credit need in the last six months. The credit card figures are relatively consistent in terms of approach (in terms of the relative time periods) and success rate.

Figure 8: Comparison of CBR survey and FPB survey

| | CBR survey 2007 | | FPB/Graydon research | |
|-------------------------------|-----------------|------------|----------------------|------------|
| | Approached | Successful | Approached | Successful |
| Overdraft | 56% | 75% | 36% | 62% |
| Commercial loan or mortgage | 39% | 85% | 26% | 48% |
| Leasing or hire purchase | 33% | 88% | 15% | 84% |
| Factoring/Invoice discounting | 3% | 93% | 4% | 84% |
| Credit cards | 36% | 70% | 8% | 72% |
| Equity finance | 2% | 93% | 5% | 51% |
| Credit from supply chain | n/a | n/a | 13% | 90% |

Success figures for leasing and hire purchase have broadly remained constant in spite of a worsening economic climate, while figures for factoring/invoice discounting have dropped slightly. Equity funding has also dropped in its success rate, but almost doubling in the proportion prepared to consider this option valuing the access to finance and financial advice given as of greater importance than the potential loss of control within the business. The doubling of approaches and halving of success rates indicates that a static level of funding through equity finance for businesses.

There was little difference in success rate according to the amount required, although there was a higher rate for businesses looking for between £100,000 and £499,999. These businesses looked to a larger number of sources were more reliant than other businesses on personal credit from directors, friends or family.

The lower success rate and the wider number of sources needed to meet the required amount are characteristics for innovative and high growth businesses, that is, higher risk businesses⁽⁴⁾ and is an indication of risk aversion over the last two quarters.

Figure 9: Refusal rates based on the amount required

| Amount required | Under £1,000 | £1,000 to £4,999 | £5,000 to £9,999 | £10,000 to £19,999 | £20,000 to £49,999 | £50,000 to £99,999 | £100,000 to £499,999 | £500,000 or more |
|-----------------------------------------|--------------|------------------|------------------|--------------------|--------------------|--------------------|----------------------|------------------|
| Refusal on one from one or more sources | 0% | 36% | 33% | 34% | 42% | 40% | 52% | 39% |
| Number of sources | 1.0 | 1.8 | 1.4 | 2.1 | 2.2 | 2.3 | 2.7 | 2.3 |
| Success rate | | | | | | | | |
| Business loans | - | 18% | 13% | 38% | 38% | 53% | 60% | 63% |
| New/extended overdraft provision | 100% | 45% | 56% | 65% | 61% | 58% | 51% | 66% |
| Hire purchase or leasing agreement | - | 9% | 13% | 24% | 29% | 25% | 35% | 29% |
| Invoice discounting or factoring | - | - | - | 5% | 6% | 11% | 16% | 5% |
| New/extension to credit card facilities | - | 32% | 4% | 10% | 13% | 8% | 10% | 11% |
| Equity finance | - | - | - | - | 6% | 4% | 24% | 26% |
| Credit from your supply chain | - | 27% | 11% | 24% | 24% | 30% | 12% | 11% |
| Loans from directors, friends or family | - | 45% | 42% | 46% | 43% | 40% | 57% | 21% |

As the economic climate turns from recession to recovery, it is unsurprising that businesses are looking to finance for cash flow issues and investment in the future. Businesses that were looking for short-term bridging loans were comparatively successful, whilst those which required credit to cover suppliers going into insolvency or looking to refinance the business were far less so.

Those looking to a larger number of sources were more likely to have experienced refusal from one or more providers of commercial finance.

Figure 10: Refusal rates analysed by the reason for looking for finance

| | Total | Under £10,000 | £10,000 to £50,000 | £50,000 to £100,000 | Over £100,000 |
|-------------------------------------|-------|---------------|--------------------|---------------------|---------------|
| Reason for requiring finance | | | | | |
| Investment and working capital | 28% | 20% | 38% | 15% | 24% |
| Working capital only | 44% | 69% | 39% | 58% | 25% |
| Investment only | 28% | 11% | 23% | 27% | 51% |
| Refusal rates | | | | | |
| Base | 40% | 35% | 38% | 38% | 48% |
| Investment and working capital | 63% | 56% | 63% | 50% | 72% |
| Working capital only | 35% | 34% | 26% | 47% | 50% |
| Investment only | 24% | 0% | 18% | 14% | 34% |

Businesses that focussed on working capital only or for growth were more likely to access funding than those who were looking for capital to meet both these needs. The refusal rates for all types of business rose based on the amount of finance they required.

The results of the FPB's Referendum ballot in September 2009 entitled "Preparing for Growth"⁽⁵⁾ highlighted that finance for growth has deteriorated at a faster rate than access to other finance generally. This may be because FPB members have longer credit histories than typical businesses and so will have comparatively fewer problems in accessing working capital.

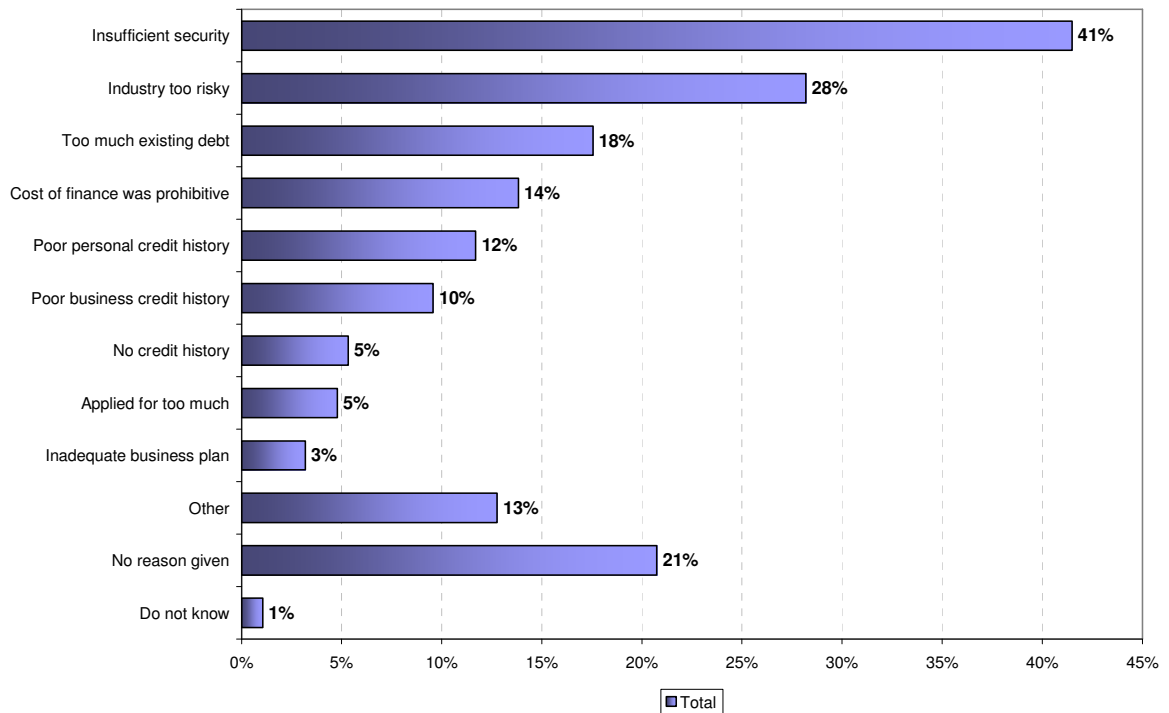
Reasons for having been refused credit

As property values (commercial and residential) have declined, security has become a big issue, with banks demanding more of it from businesses. Comments from respondents indicate that some owners felt the assets required were many times the value of the loan, while others indicated that they were unhappy in putting their family homes on the line.

In some instances, those citing too much existing debt also indicated that security was an issue, as they had no more assets to provide.

Industries that were once treated with caution, such as construction, automotive and restaurants, are now unable to get any credit. Worryingly, business owners in a number of industries that have been defined as being key to Britain's future (biotech, low carbon and so on) are also saying that they are unable to get funding for research purposes.

Figure 11: Reasons given for refusal of credit



Personal credit is only an issue for micro companies, particularly those with fewer than five employees, whilst industry problems are more of a concern for small businesses (10 to 49 employees). The sample size for medium-sized businesses is too small to draw any conclusions.

Figure 12: Reasons given for refusal of credit based on size of company

| | Total | Micro | Small | Medium |
|---------------------------------|-------|-------|-------|--------|
| Insufficient security | 41% | 43% | 43% | 29% |
| Industry too risky | 28% | 23% | 45% | 12% |
| Too much existing debt | 18% | 20% | 18% | 0% |
| Cost of finance was prohibitive | 14% | 14% | 18% | 0% |
| Poor personal credit history | 12% | 19% | 0% | 0% |
| Poor business credit history | 10% | 12% | 4% | 12% |
| No credit history | 5% | 5% | 4% | 12% |
| Applied for too much | 5% | 5% | 2% | 12% |
| Inadequate business plan | 3% | 4% | 2% | 0% |
| Other | 13% | 12% | 13% | 18% |
| No reason given | 21% | 20% | 18% | 24% |
| Do not know | 1% | 2% | 0% | 0% |

Although there are differences in the way in which the CBR carried out its research and that it looked for a single response rather than multiple options, the table below clearly emphasises a number of key changes in access to credit, particularly in the case of business credit history and insufficient security.

Figure 13: Reasons given for refusal of credit in 2009 compared to 2007⁽³⁾

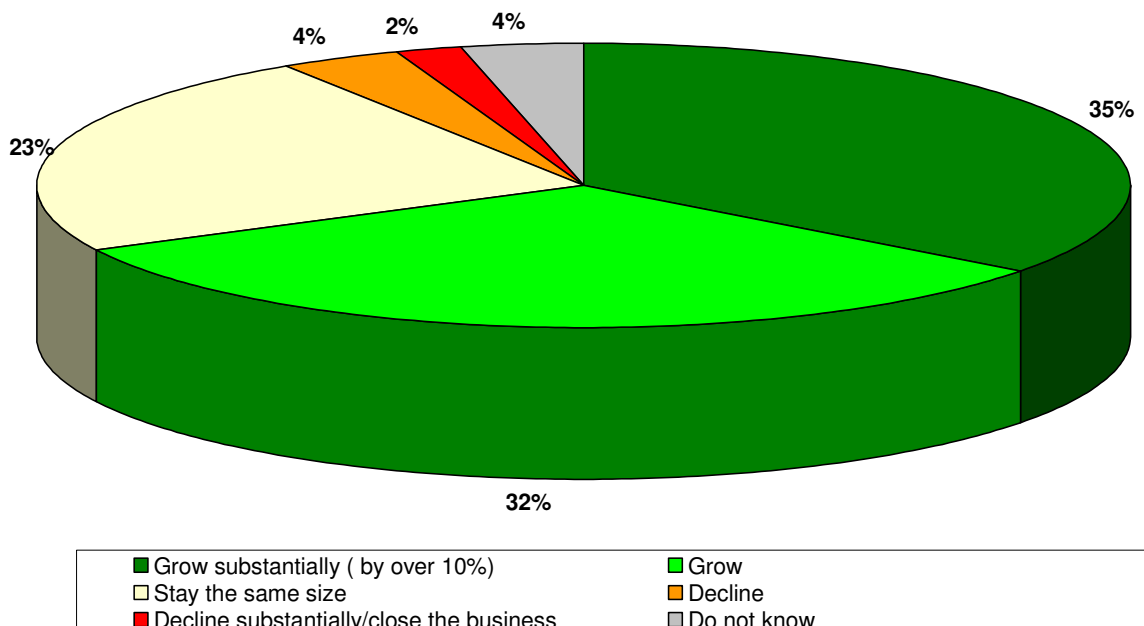
| | Overdraft | | Loans | | Leasing/HP | |
|---------------------------------|-----------------|-------------|-----------------|-------------|-----------------|-------------|
| | FPB/ Graydon | CBR 2007 | FPB/ Graydon | CBR 2007 | FPB/ Graydon | CBR 2007 |
| No credit history | 7% | 17% | 8% | 4% | 0% | 17% |
| Poor personal credit history | 18% | 15% | 10% | 1% | 0% | 20% |
| Poor business credit history | 12% | 2% | 10% | 1% | 28% | 21% |
| Insufficient security | 45% | 14% | 48% | 9% | 33% | 20% |
| No security | n/a | 5% | n/a | 1% | n/a | 0% |
| Too much existing debt | 19% | 6% | 24% | 0% | 0% | 0% |
| Inadequate business plan | 6% | 5% | 3% | 0% | 0% | 0% |
| Applied for too much | 5% | 2% | 9% | 0% | 0% | 0% |
| Industry too risky | 25% | 0% | 30% | 3% | 33% | 0% |
| Cost of finance was prohibitive | 16% | n/a | 13% | n/a | 22% | n/a |
| Other | 14% | 8% | 13% | 31% | 17% | 15% |
| No reason given | 25% | 6% | 24% | 29% | 22% | 22% |
| Do not know | 2% | 20% | 2% | 21% | 0% | 24% |

Plans for 2010

The figures from this survey broadly fit with those of the September 2009 BIS SME Business Barometer⁽²⁾, the results of which showed that 63% of respondents were looking to grow in 2010. The figures from our research are slightly higher and may suggest a greater optimism as the year ended.

Around 2% of businesses are due to decline substantially over this period, many closing due to lack of credit; however, this may mask more severe issues with the business model.

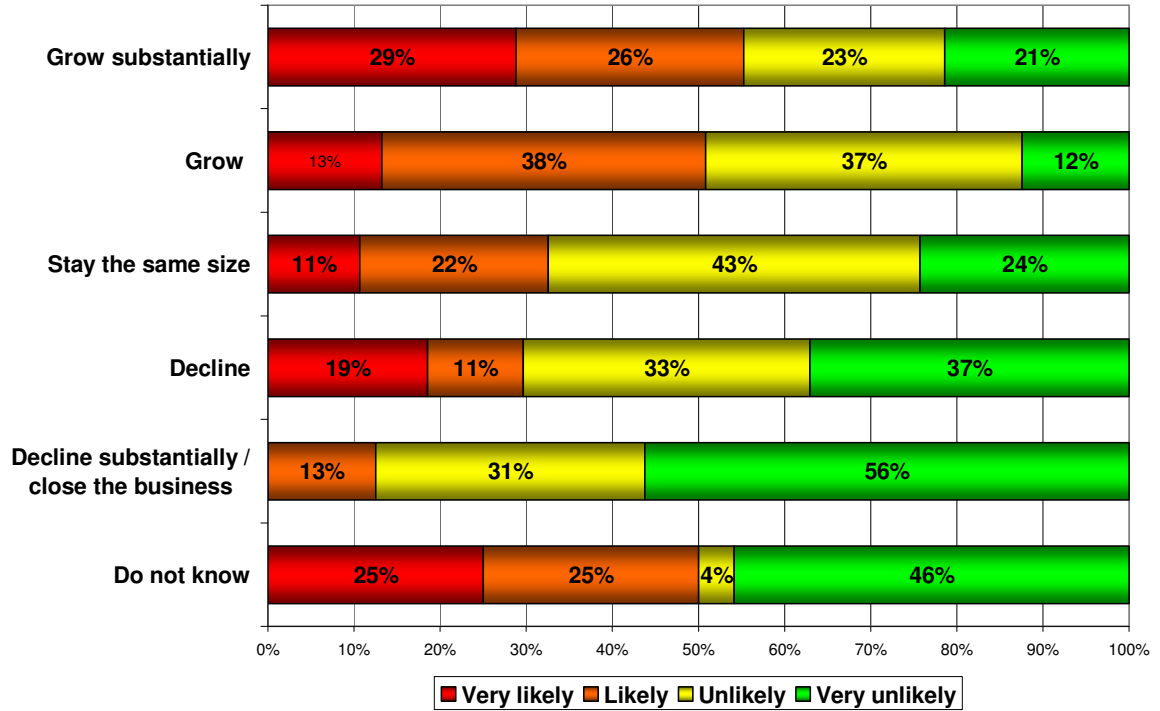
Figure 14: Business plans for 2010



Likelihood of businesses requiring finance in 2010

44% of those businesses looking to grow substantially in 2010 and 48% of those which anticipate growing do not plan to access further finance in 2010. Micro businesses are less likely to require funding, even if they are looking to grow substantially; however, 50% of micro businesses are likely or very likely to require additional finance in 2010 to fund their development plans.

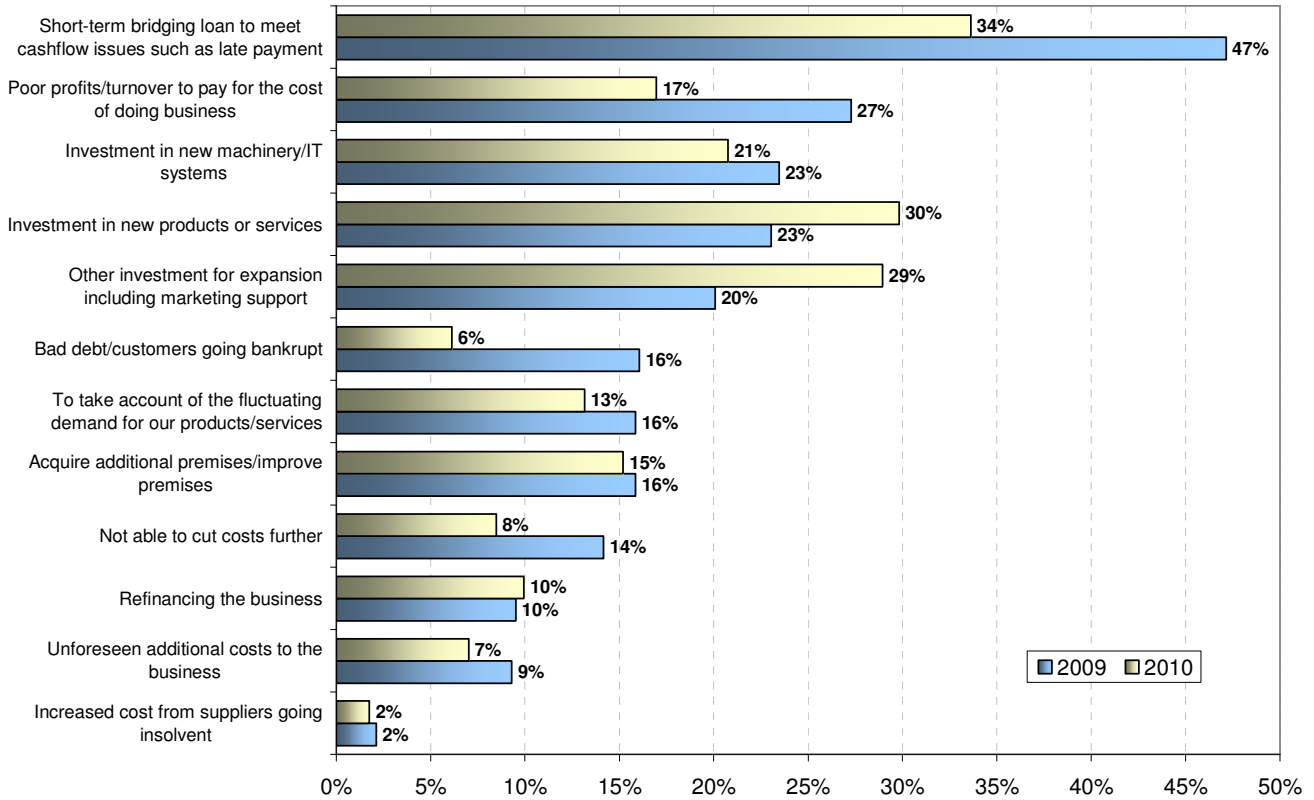
Figure 15: Likelihood of requiring finance in terms of plans for the business



Reasons businesses want to access finance

Based on these figures, 7% of all micro, small and medium-sized business employers will continue to need short-term bridging loans in 2010, which will be the main requirement in terms of external finance. This indicates that there will be a recessionary 'hangover' for at least part of 2010 as companies do not expect their profitability to improve overnight.

Figure 16: Reasons why the business requires finance in 2010 compared to 2009

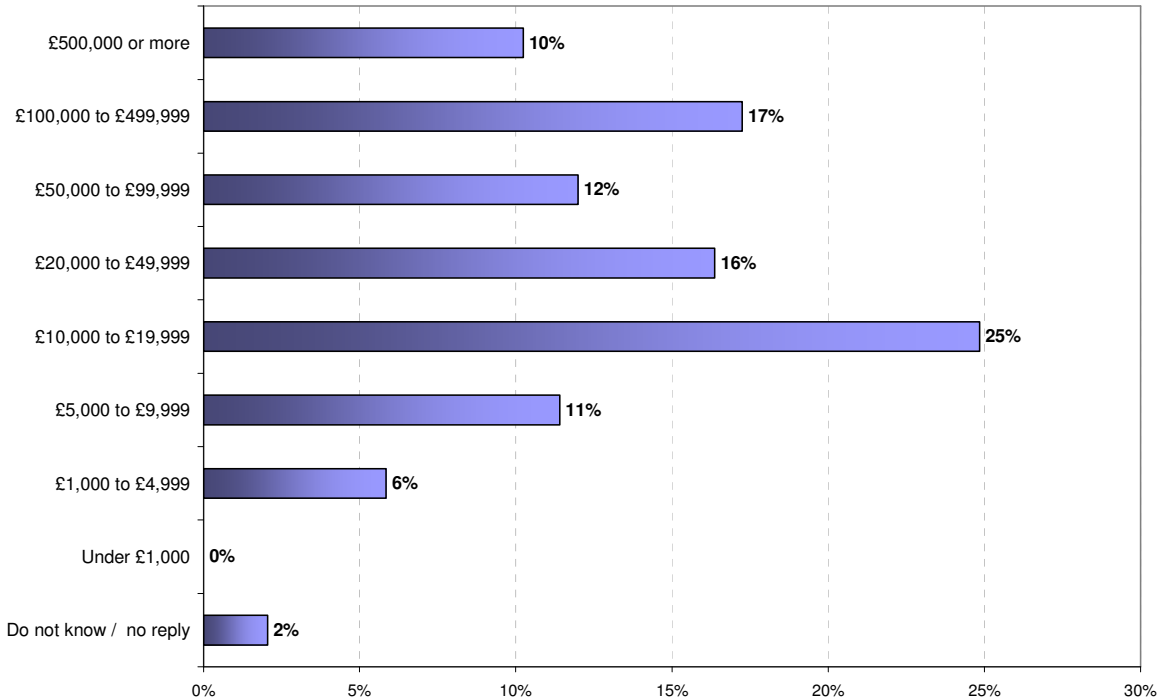


On a more positive note, businesses are expecting late payment and bad debt to decrease in 2010. Elsewhere, businesses are more likely to be looking for investment.

How much money businesses will require in 2010

27% of respondents who anticipate a need for external finance in 2010 expect that they will require more than £100,000. In general, the numbers anticipating funding will drop in 2010, as will the average amount required by small and medium-sized businesses. Micro businesses in particular do not expect to borrow much less in 2010 and medium-sized businesses will require, on average, slightly more. Small businesses (those with between 10 and 49 employees) will be polarised between those that will need a much higher level of funding to meet their future needs and those that anticipate keeping the amount required to a minimum.

Figure 17: Amount of finance required in 2010



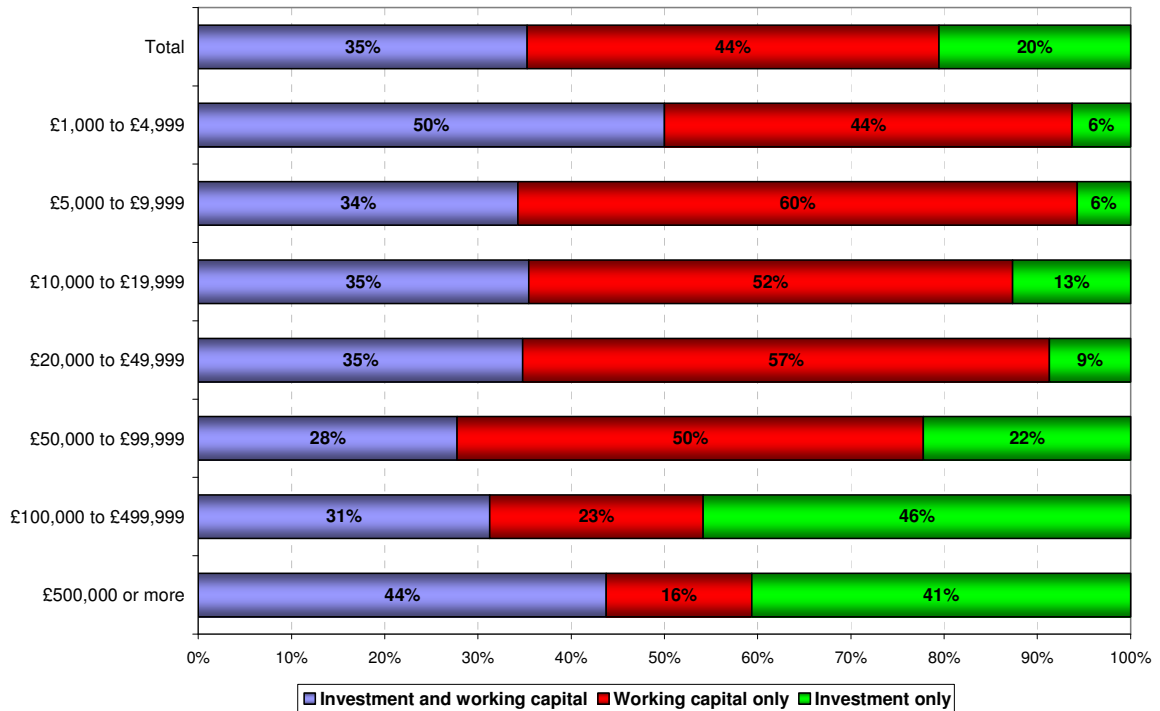
Fewer businesses anticipate requiring credit in 2010; however, those that do will tend to need more due to the greater capital requirements for growth. The big difference between the mean and median in micro and medium-sized business employers indicates a polarisation between businesses which have relatively cautious spending plans and those that need significant injections of capital to meet their needs.

Figure 18: Average amount of credit sought in 2010

| | Mean amount required by firms seeking credit | Median amount required by firms seeking credit | Mean amount of lending required by all firms |
|-------------------|----------------------------------------------|------------------------------------------------|----------------------------------------------|
| All businesses | £113,731 | £34,995 | £51,035 |
| Micro businesses | £56,708 | £12,936 | £23,061 |
| Small businesses | £136,140 | £72,262 | £67,773 |
| Medium businesses | £334,118 | £75,250 | £192,542 |

Construction companies will again look for a higher than average amount of funding in 2010, indicating a comparative lack of success in accessing credit in 2009.

Figure 19: Amount of finance sought in 2010 by the reason for seeking it



Those businesses which anticipate borrowing more than £100,000 are more likely to be looking for finance to grow their businesses, while those expecting to need to borrow less than £5,000 are looking to use the money to keep their businesses afloat and cover modest investment in the business.

Proportion of finance to be sought from banks and elsewhere

One in five respondents do not anticipate looking to the banks for additional credit in 2010. 38% of micro businesses will be looking for less than half of their capital needs from banks; however, this included a high proportion of the larger capital requirements (over £100,000).

Figure 20: Proportion of finance in 2010 that will be sought from banks

| | Base | Micro | Small | Medium |
|----------------------------------------------|--------|--------|--------|---------|
| No reply | 2% | 3% | 0% | 0% |
| None | 20% | 22% | 17% | 15% |
| Less than 25% | 7% | 8% | 3% | 9% |
| 25% to 49% | 5% | 7% | 4% | 0% |
| 50% to 74% | 18% | 15% | 18% | 21% |
| 75% to 99% | 12% | 10% | 16% | 15% |
| All | 37% | 34% | 41% | 41% |
| Proportion anticipated from banks (weighted) | 60% | 42% | 66% | 69% |
| Average amount (mean) sought from banks | 60,053 | 23,642 | 90,211 | 230,033 |
| Average amount (mean) sought from elsewhere | 45,678 | 33,064 | 45,929 | 104,085 |

Small and medium-sized businesses anticipate the majority of funding will come from the banks. This figure may be an underestimation, though, as no account has been made for those which may need further finance that they have not planned for.

Figure 21: Other main sources of alternative finance

| | Total | Micro | Small | Medium |
|---------------------------------------|-------|-------|-------|--------|
| Government grants | 29% | 28% | 36% | 0% |
| Supply chain (suppliers or customers) | 24% | 22% | 23% | 50% |
| Venture capitalists | 20% | 21% | 20% | 17% |
| Company directors, friends and family | 66% | 61% | 66% | 83% |
| Credit cards | 13% | 14% | 11% | 8% |
| Building societies | 3% | 4% | 0% | 0% |
| No reply/other sources | 6% | 0% | 14% | 17% |

Businesses are not looking for support from the banks for additional lending as they do not perceive that they will get it “until you do not need it”. Banks were not seen as supportive in terms of the speed of decision-making, time taken in complying with the criteria placed on them by banks, centralised decision-making and their tendency towards risk aversion. Risk aversion is particularly a concern for companies looking to grow if they are considered as being in the wrong industry (automotive, engineering or construction), lack current profits or lack a credit history, when looking at diversification.

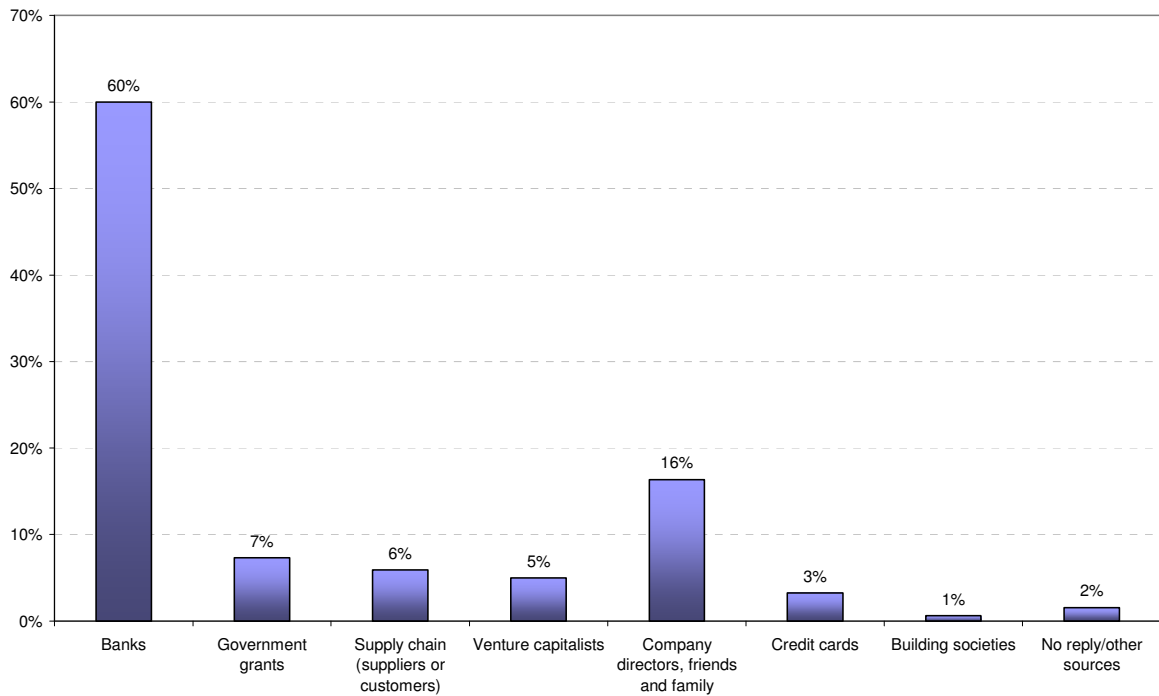
Other problems with the banks were based on the amount of finance needed (too small so preference for credit cards or personal credit to top the scheme up) or too big (requiring venture capital funding and support).

However, respondents are not looking to other finance providers on the high street few businesses would consider using building societies for finance, indicating that they are not currently seen as a credible alternative to the banks.

Reasons for looking to other types of finance included specific support schemes, such as the need for credit from HMRC’s Time to Pay scheme for the survival of the business and that the need for venture capital style support in an industry where there is little traditional equity funding.

Banks are still required to provide the majority of funding to businesses, as the chart below indicates.

Figure 22: Comparison between probable providers of finance in 2010



Main obstacles for businesses in terms of finance in 2010

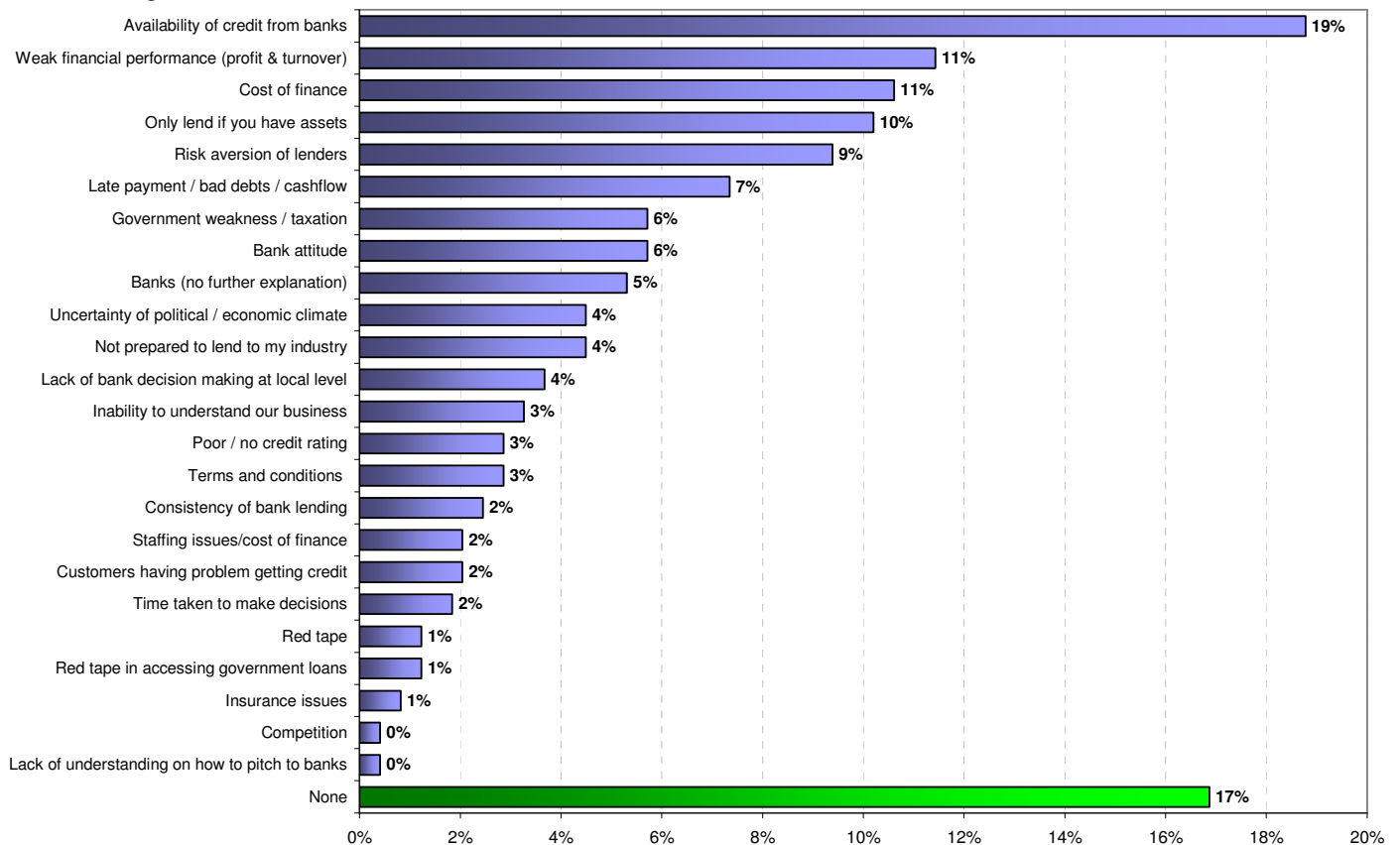
Only two thirds of businesses responded to this question, indicating the number anticipating no main obstacles to finance. Although 22% indicated that the recession had made them less creditworthy (11% indicated that turnover and profitability had deteriorated, 3% cited credit rating issues and 7% indicated cash flow was expected to have an impact in 2010), many felt that the banks in particular were unwilling to lend to their business at a reasonable rate.

19% of respondents indicated that the availability of credit was expected to be a key issue for businesses in 2010. Availability of credit was a far greater concern than cost, with twice as many respondents citing this as an obstacle to accessing finance.

Cost of finance had a number of aspects to it; many respondents were concerned about the sharp rise in base rate anticipated in 2010 if there is a sustained recovery and the amount they were currently paying over that for their current agreements. Charges for setting up and maintaining credit facilities were the most frequently cited issue in terms of the cost of finance, although these referred to venture capital funding as well as banks.

Risk aversion by financial companies was the third key issue which was anticipated to continue in 2010. This is broken down in the chart below into general risk aversion to growth strategies (9%) and the perception that financial providers are simply not touching certain industries, including real estate, pubs and restaurants, construction, automotive, and research and development.

Figure 23: Main obstacles for businesses in terms of finance in 2010



Impact of European Competition Commission’s ruling on the Royal Bank of Scotland and Lloyds Banking Group

4% of businesses mentioned the uncertainty about the political and economic climate in 2010 and one element of this will be the change to the financial system as a result of the European Competition Commission ruling on the UK banking industry to break up the Royal Bank of Scotland and the Lloyds Banking Group. For almost a third of small businesses, this adds a further element of uncertainty to the year ahead. Under 5% of respondents feel that it will be a benefit and almost one in seven thinks it will have a negative impact on their business. Around 50% believe it will have no impact on them; this may be because these respondents have bank accounts with other banks.

Figure 24: Anticipated impact of the European Competition Commission ruling on banking groups

| | Total | Micro | Small | Medium |
|-----------------|-------|-------|-------|--------|
| No reply | 2% | 1% | 3% | 2% |
| Positive impact | 3% | 3% | 3% | 0% |
| No real impact | 50% | 53% | 42% | 64% |
| Negative impact | 13% | 9% | 19% | 14% |
| Do not know | 31% | 33% | 33% | 19% |

The sample size for businesses that felt there would be a positive impact predominantly cited the advantages of greater competition and choice. These were also expected to have an impact in improving access, terms and conditions for niche businesses by the creation of smaller banks – with greater local autonomy – that would be more understanding of businesses’ needs.

Figure 25: Reason for this response

| | Positive impact | Negative impact |
|---------------------------------|-----------------|-----------------|
| Sample size | 22 | 97 |
| Competition/choice | 82% | 16% |
| Terms and conditions of lending | 55% | 39% |
| Access to finance | 45% | 41% |
| Cost of finance | 36% | 44% |
| Advice on finance | 0% | 8% |
| Customer service | 14% | 28% |
| Interest on deposit accounts | 0% | 18% |
| Do not know | 0% | 2% |

Respondents were concerned about competition and choice, in terms of the larger lending requirements (in fact, a higher proportion of businesses felt that competition would decrease than increase). The cost of finance would also deteriorate as economies of scale could not be utilised and access to credit could be an issue for business accounts that were jettisoned by banks to meet the anticipated size requirements.

Credit ratings

Larger companies are more likely to monitor their supply chains, with 54% of businesses with 50 or more employees undertaking credit checks on both their suppliers and customers. A small number of businesses monitor their suppliers only, but more than one in four businesses do not check at all and a similar proportion only check after there is a problem with an account.

Figure 26: Use of credit ratings by businesses on their supply chain

| | Total | Micro | Small | Medium |
|-------------------------------------------|-------|-------|-------|--------|
| No reply | 2% | 2% | 1% | 0% |
| Both suppliers and customers | 15% | 7% | 22% | 54% |
| Suppliers only | 1% | 2% | 1% | 0% |
| Customers only | 30% | 29% | 37% | 14% |
| Only check on them when there is an issue | 25% | 28% | 21% | 15% |
| Do not check | 26% | 32% | 18% | 17% |
| Do not know | 1% | 1% | 0% | 0% |

69% of those that regularly monitor their suppliers are likely to use the results in negotiating terms and 90% of those that monitor their customers do the same. Those that check on both suppliers and customers are more likely to use credit ratings in considering the terms they offer to them.

Figure 27: Effect of credit ratings usage on the supply chain

| | Total | Whether this affects the terms offered to | |
|------------------------------|-------|-------------------------------------------|-----------|
| | | Suppliers | Customers |
| Both suppliers and customers | 15% | 69% | 91% |
| Suppliers only | 1% | 42%* | n/a |
| Customers only | 30% | n/a | 88% |

*Very small sample (<20)

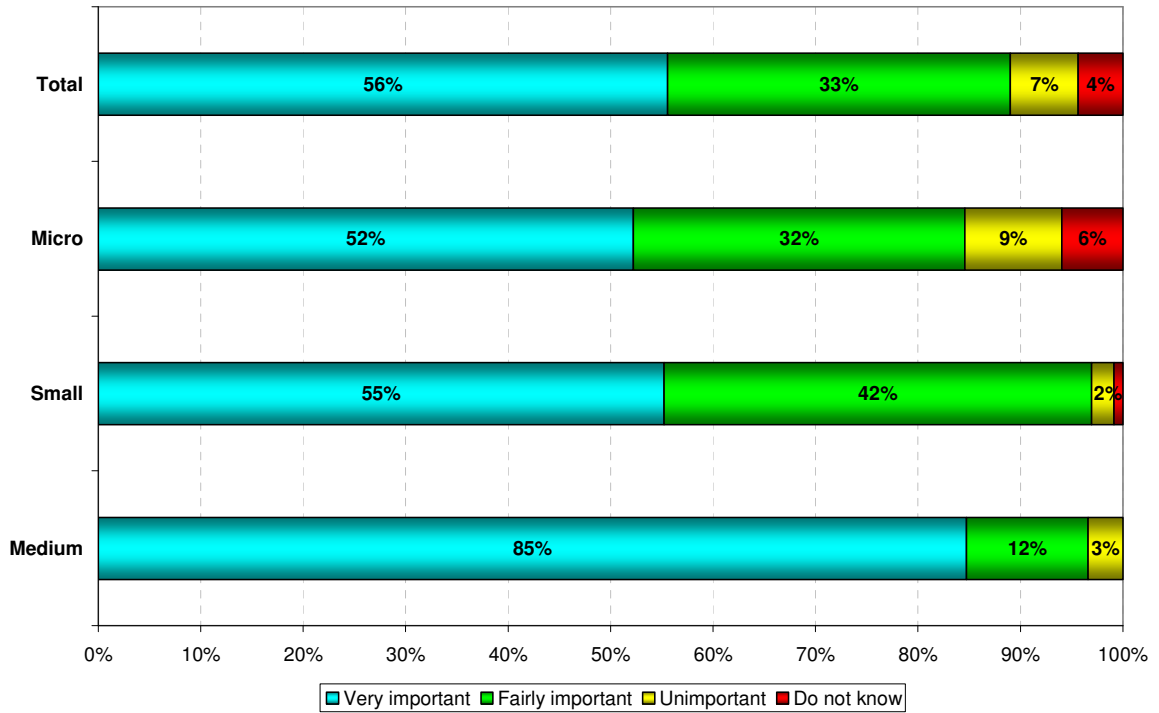
Almost one in three micro businesses did not know what their credit rating was and 50% felt that their own credit rating was above average. These companies were more likely to get funding in the past and more likely to anticipate access to significant amounts in 2010 for their growth strategies.

Figure 28: Businesses current credit rating

| | Total | Micro | Small | Medium |
|-------------|-------|-------|-------|--------|
| Good | 50% | 44% | 53% | 85% |
| Average | 17% | 17% | 20% | 10% |
| Poor | 6% | 6% | 7% | 3% |
| No reply | 4% | 4% | 3% | 0% |
| Do not know | 22% | 29% | 17% | 2% |

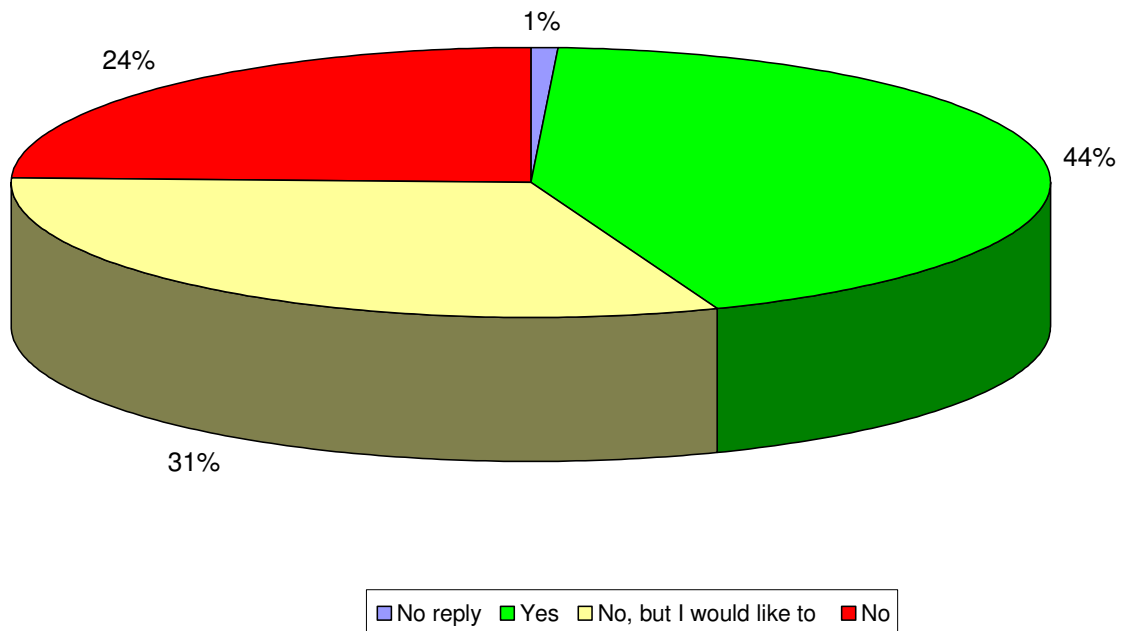
Over 50% of the micro businesses surveyed felt that, in 2010, credit ratings would be very important, compared to 55% of small businesses and 85% of medium-sized businesses. 71% of those which were refused credit in 2009 for credit rating issues (personal and business) felt that their credit rating would be very important in 2010 and 68% of those respondents intending to grow their businesses felt the same.

Figure 29: Importance of credit ratings in 2010



Currently, 44% of businesses know how they can influence their credit rating. Although this rose in direct relation to the size of the business, over 20% of medium-sized business owners did not know how to improve their credit rating. Micro businesses were relatively equally split, with 34% knowing how to influence their credit rating, 35% not but wanting to and 30% not interested.

Figure 30: Ability to influence their credit rating



Other sources of information

- (1) Dooks D, small business figures from the high street banks October/November 2009, <http://www.bba.org.uk/bba/jsp/polopoly.jsp?d=145&a=17121>, January 2010.
- (2) BIS, SME Business Barometer, September 2009, <http://www.berr.gov.uk/files/file54062.doc>, November 2009.
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- (4) Parry T, Referendum 189 Preparing for Growth, <http://www.fpb.org/page/104/Referendum.htm> FPB November 2009.
- (5) A Cosh et al, SME finance and innovation in the current economic crisis, http://www.cbr.cam.ac.uk/pdf/CrCr_EconCrisis.pdf December 2008, CBR.

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