Funding without fuzz

PETER MATZA REPORTS ON THE LATEST ACT BRIEFING FOR NON-EXECUTIVES WHICH EXPLAINED THE NEED FOR COMPLETE CLARITY WHEN LOOKING TO SECURE CORPORATE FUNDING.

The latest in a series of ACT lunchtime meetings for non-executive directors in the SME sector, held in early May, concentrated on non-bank funding and the state of corporate/bank relationships in lending. The speakers included Miriam Greenwood of Brewin Dolphin Investment Banking (see Profile, page 42), ACT chief executive Stuart Siddall, ACT assistant director Martin O'Donovan, and Marc Palley, practice group head for banking and capital markets at Berwin Leighton Paisner, the lunch hosts.

The current scene is one in which bank lending is difficult and time-consuming to arrange, is relatively expensive and could be considered precarious as regulatory capital constraints begin to bite. The climate of risk aversion and the exit of many non-UK banks from the UK market have created a vicious circle of reduced competition that has raised prices in all bank products and services. Corporates cannot rely on their relationships with even longstanding banks and must respond to "wallet" demands from those that remain engaged. The move towards Basel III will maintain this pressure. Other financing markets – such as traditional asset-backed securities – have also suffered considerable diminution in volume, which in turn leaves bank balance sheets strained and feeds back into their ability to advance new loans. Where then do corporates – especially those down the credit and size scale – go for additional or replacement funding?

The clear message for all those involved in reviewing the choices is to be clear in your objectives (particularly as regards capital structure), to be aware of what options are being offered (and by whom), and to pay attention to the detail of the documentation involved (are you giving security or control over your business decisions?). There are perhaps three main funding options available.

Equity Whether it is offered in straight issuance, an initial public offer (IPO) or even one of the current forms of convertible issuance, equity remains a realistic avenue of capital generation for SMEs. Institutional investors often prefer straight issuance, but convertibles can be interesting as they are flexible on terms and the credit of the issuer and they carry lower coupons for borrowers (at the cost of selling equity albeit at a premium).

Asset-based/backed financing While some delegates at the lunch expressed disquiet about the lack of competition in the UK market (the providers are generally the UK clearers), there are aspects to invoice financing that can appeal to almost all sizes of business. The devil is in the detail as to whether the funding is with or without recourse (or other security) and what the real costs are. Often the financing bank can be very picky as to what sorts of invoices are eligible, so reducing the quantum of finance available. And of course you must have receivables there in the first place. The nascent world of supply chain finance and "reverse funding" (where a credit-strong buyer makes finance available via a bank to its credit-weak suppliers) can also offer interesting opportunities.

Non-bank investment Access to the US private placement market is generally limited to companies needing $75m or above and with EBITDA over £50m, so it's not for all businesses. However, a US private placement is a well-trodden path for UK corporates that meet the minimum criteria, and US investors can fund even in sterling and euro these days. A Fitch/Moody's/S&P credit rating is not needed but ex-post a rating from the US-based National Association of Insurance Commissioners (NAIC) will be sought by the investors. The UK has seen a number of initiatives in the development of a domestic private placement market lately, via investors such as M&G and Aviva, but there are still hurdles in documentation and pricing to overcome. A point of discussion here was the lack of transparency in banks' pricing of non-lending products (such as foreign exchange transactions); the banks argue that these lucrative products cross-subsidise their basic lending.

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