Improving the plumbing

THE MARCH BUDGET SHOULD CONTAIN A RANGE OF OPTIONS FOR BOOSTING NON-BANK FINANCE, COURTESY OF A TASKFORCE THAT HELD ITS FIRST MEETING IN JANUARY. **PETER WILLIAMS** REPORTS.

George Osborne's Budget on 21 March is due to contain recommendations on how to boost non-bank finance options for business. Those options should come from the evidence and recommendations of the taskforce, led by Legal & General chief executive Tim Breedon, which was set up by Osborne's cabinet colleague Vince Cable. The taskforce offers an industry-led examination of the structural and behavioural barriers to the development of non-bank sources of finance.

At the time, Cable said: "Businesses across the UK are still in many cases unhappy with the way they have been treated by banks. We have secured a rise in new lending from the biggest banks this year and credit easing is designed to provide another immediate boost. But I want to see as much competition in the market as possible and for businesses to have access to a wide range of finance sources.

"There are exciting innovations emerging that provide alternatives to bank lending. Businesses are selling bonds directly to their customers, missing out the middlemen. And peer-to-peer lending has opened up opportunities for savers to invest directly in the fortunes of UK businesses. I want to investigate and dismantle any barriers to these and future innovations."

As The Treasurer went to press, the working party was due to meet with Cable to present its high-level findings. As part of the Budget process it is expected that Breedon's report into the findings of the taskforce's enquiries will be published, although that will require the go-ahead from the chancellor.

The taskforce has received over 100 responses to its call for evidence, and has also gathered evidence from seven regional and technical workshops held with businesses and market participants.

The CBI has told the Breedon taskforce that an opportunity exists to create a "more sustainable business finance landscape" that would lessen the impact of any future economic shocks on the ability of small firms to borrow and continue to grow their business. The employers' organisation suggested that diversifying sources of finance beyond straight bank lending would help put a "spare tyre" in the system in case of a banking breakdown. It suggests that smaller companies should distinguish not between debt and equity but between working capital needs and growth capital needs, both of which could be met by either debt or equity finance.

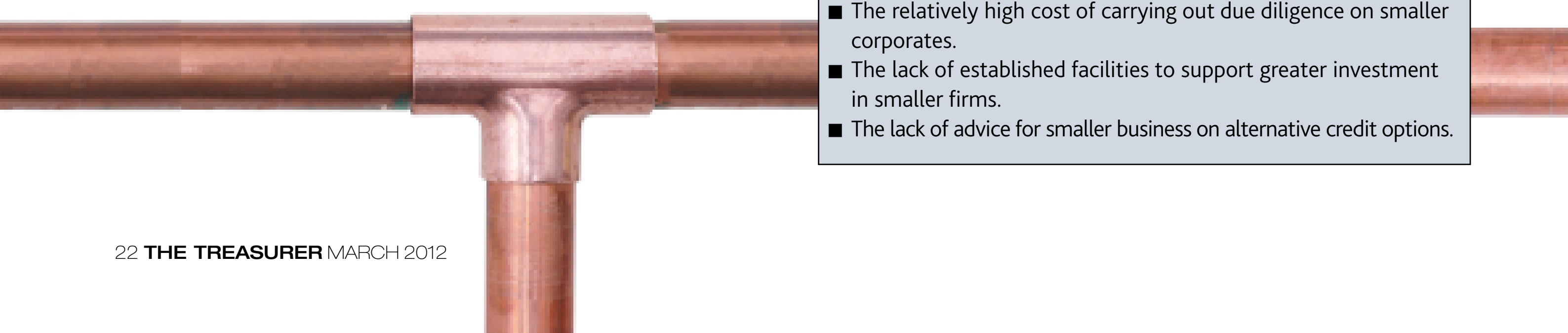
Respondents to Breedon are clear that there is scope for significant improvement in the UK's current lending landscape. The UK has the smallest bond market capitalisation relative to GDP in the G7 and the most highly concentrated banking sector. The CBI argues that countries like Germany and the US have bond markets which are more accessible to medium-size businesses (MSBs), and in the US much smaller firms are able to issue private placements than is possible in the UK. See the box on this page for the CBI's identified barriers to non-bank finance.

The Loan Market Association (LMA), which emphasises that it has consulted with its non-bank members, says that the syndicated loans market should not be overlooked when considering the development of alternative debt markets. It describes the syndicated

The non-bank barriers

Barriers to the supply of a more diverse range of lending options identified by the CBI include:

- The low visibility of alternative credit providers.
- The relatively high cost of carrying out due diligence on smaller corporates.
- The lack of established facilities to support greater investment in smaller firms.
- The lack of advice for smaller business on alternative credit options.



The four ambitions

The Breedon taskforce's report to the chancellor is likely to focus on:

1. ACCESS TO BOND MARKETS Companies with less than £1bn turnover have traditionally been shut out of the bond market. The retail bond market has shown some signs of life – the one from the most recent Deals of the Year overall winner National Grid is a fine example. The London Stock Exchange's orderbook for retail bonds (ORB) is three years old and many finance experts think retail bonds could be an opportunity to diversify away from traditional loan financing. But how?

2. BUSINESS-TO-BUSINESS FINANCE Big corporates are sitting on piles of cash as never before. Can the Breedon taskforce find a way to deploy these surpluses commercially in the supply chain? Vendor financing is already part of the financial mix in the UK but could that be expanded? For instance, if smaller companies buy or lease equipment from larger companies, could finance be part of the deal?

3. BANKS AS ARRANGERS OF FINANCE They may not have the balance sheets any more to help, but banks do have extensive skills in making lending decisions and the network to reach virtually all parts of business across the UK. For instance, could they act as arrangers for asset-backed loans from pension funds or insurance companies?

4. FACTORING AND INVOICE DISCOUNTING These products are not new and are still seen as a last resort, but does part of the answer lie in a reinvigoration of factoring and invoice discounting to provide a boost to working capital?

Supply chain finance – the ACT take

In 2009 the Bank of England asked the ACT to examine alternative ways of providing additional capital to small and medium-sized companies (SMEs), as bank lending was already constrained in this area. One of the main goals of the ACT study was to assess whether there was demand for an expansion of the supply chain finance (SCF) market. The ACT-chaired working group concluded that no particular SCF structure should be singled out as the preferred option. However, all buyer-driven receivable programmes will help to ease funding in current market conditions.

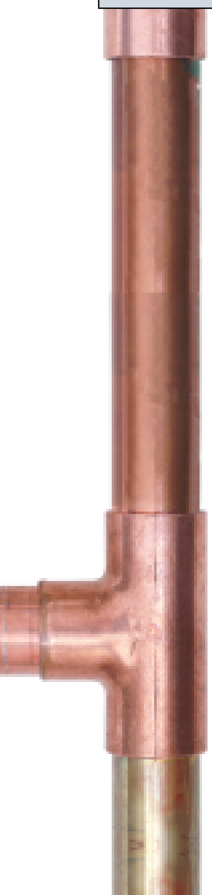
The ACT identified four barriers to the expansion of the SCF market:

- poor understanding of the differences between SCF mechanisms;
- relatively few banks fund the market;
- a negative misperception exists about the use of SCF; and
- accounting for SCF mechanisms is complex and uncertain.

The report – which seems to have stood the test of time well – placed SCF structures into four main categories:

- supplier-driven programmes (receivables, factoring/discounting);
- purchasing cards;
- inventory finance; and
- buyer-driven programmes.

It remains to be seen how much Breedon and then HM Treasury revisits and revives these ideas



loan product as an "attractive, simple and flexible source of funding" for businesses with a turnover between £25m and £500m.

One of the barriers to the development of a non-bank finance market is regulation. The LMA says that the government should assist with lobbying initiatives in this area. In particular, it warns against the danger of the proposed regulation of the "shadow banking" industry having unintended consequences for regulated institutional investors and their ability to be part of the alternative finance solution. The LMA suggests that banks too have a part to play in alternative sources of finance. It says they should maintain a key role in providing working capital finance such as letters of credit and overdrafts as institutional investors are unlikely to provide ancillary facilities.

LMA managing director Clare Dawson says: "While non-bank investors are already present in the syndicated loan market, much could still be done to broaden this valuable investor base and give it a meaningful diversity."

The ACT says it is pleased to be able to contribute to this process and has been assigned to lead on one of the taskforce's workstreams, with ACT president James Douglas – who is a member of the working party – taking the chair. The ACT-led subgroup is considering asset-based finance, drawing in particular on previous work done around supply chain finance programmes and private placement markets. The ACT has been looking at the issue of alternatives to bank finance since the credit crisis first arose and has looked at a UK private placement market, supply chain finance and mezzanine finance.

According to Breedon, much of the taskforce's approach to trying to boost business investment will focus on the "plumbing" that connects providers of finance with the corporate users of funds. There are four main areas where improvements could be made (see The Four Ambitions box on this page).

Businesses moaning about lack of access to finance has been a hardy perennial and the Breedon taskforce will do well to come up with any long-lasting solutions given the few weeks it has been in operation. The March Budget will not solve all of the access issues, but if mid-size business is going to contribute to economic growth one of the key aims must be to keep access to finance high on the political agenda.

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