

Beyond banks in search of funds

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Hard decisions: large margins added by banks to interest rates on loans have put off many businesses

Uncovering the truth about the availability of finance for small and medium-sized businesses has never been easy.

The heads of the high street banks claim they are willing to lend to companies but the demand is not there.

Meanwhile, business owners complain that the time lenders take to make a decision, demands for security to back loans and the thick margins added to interest rates make it more attractive to do anything other than borrow from a bank.

Henry Ejdelbaum, managing director of ASC Finance for Business, an independent broker, claims that even ordinary businesses are finding it tough to get conventional bank loans.

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"We had a baker looking to borrow money for an industrial unit, but he has really struggled to get the money," Mr Ejdelbaum says. "I think the banks are trying to be more helpful, but the volume of transactions is not there."

Alastair Stewart, managing director of Etc Venues, a training and conference venue operator, has a profitable business generating annual revenues of £18m (\$29m).

He has looked into bank borrowing to provide working capital to expand his business, but has so far refused to accept the deals offered to him.

"The point that is sometimes missed, or not as widely reported, about banks' lending to SMEs is that they are very good at cost management," Mr Stewart says.

"Many of us are just not prepared to pay interest rates and arrangement fees on new loans at 4-5 per cent over Libor," he adds, referring to the UK interbank lending rate. "My message to the banks is not to start lending but to reduce their interest rate margins, and then we will start borrowing."

The good news for companies such as Etc is that there are alternatives to bank finance. One such option that has grown in popularity is factoring, or invoice discounting, where a business borrows money against its invoices.

Also gaining traction is asset-based financing, where money is borrowed against assets such as plant or machinery. This form of financing totalled £15.1bn in the third quarter of last year, according to the most recent figures published by the Asset Based Finance Association, the UK trade body.

The lack of availability of conventional debt finance has also spawned a variety of start-ups offering new lending models.

One of these is United Kapital, based in Manchester. It provides cash advances to businesses such as restaurants and hotels that derive much of their income through credit card sales.

Tony Pegg, founder and managing director, took the idea from the US, where merchant cash-advance companies have been providing credit in this way for about 15 years. After trading for only two years, United Kapital has so far provided more than £9m of funding to SMEs.

According to Mr Pegg, he is filling a gap for companies that cannot get finance through routes

"Invoice factoring is great for businesses that offer sales by invoice, but many companies don't operate this way," he says.

Samantha and Robert McDermott turned to United Kapital to provide working capital for the Hare and Hounds, their Stockport pub, after balking at interest rates and charges amounting to 40 per cent of the loan value being offered by their bank. In comparison, United Kapital takes a fee of 18 per cent on money loaned. It also suits the Hare and Hounds' business environment, where 90 per cent of customers pay by credit or debit card.

Although the McDermotts had to change the bank providing the credit card readers that customers use to settle their bills, the overall process of getting finance from United Kapital was much easier than a term loan application with a bank, Ms McDermott claims.

"You don't have to go into the background of what you want the money for, as you would with a bank," she says. "You send some bank statements, get a credit check and you are approved."

The McDermotts also find this way of borrowing appealing because the charges are taken automatically as payments are made by customers rather than arriving as a monthly bill from the bank.

"It is brilliant because I know exactly where I stand," Ms McDermott says. "I also do not have to worry about keeping money back to pay the interest on a bank loan."

Yet another new business model for debt finance is peer-to-peer lending, in which individuals agree to lend money to each other through an online money exchange.

Zopa, a London-based start-up, pioneered this kind of lending for individuals, but the idea has been adapted for consumer-to-business lending by a company called Funding Circle, which is backed by Jon Moulton, the former head of Alchemy Partners, the private equity group.

Funding Circle says it can provide a considerably cheaper way to access finance than traditional bank lending. However, it is noteworthy that Zopa, whose average default rate is 0.7 per cent, claims to have decided against moving into the consumer-to-business market because of fears of high defaults.

ThinCats.com is another start-up trying to use the internet to create low-cost loans for business. Kevin Caley, managing director, describes it as an Ebay for secured business loans, in which lenders bid to provide finance to a company.

After trading for only a few weeks, the company has already agreed a couple of loans. The problem, as Mr Caley admits, is that such business models need to reach a critical mass of borrowers to be serious alternatives to bank finance.

There is no doubt these models have increased the options for businesses struggling to find debt finance at the right price. The question is whether they can survive as the traditional lending markets return to normality.



Simon Embley
Chief executive of
LSL Property
Services,
Newcastle

"Lack of mortgage supply, particularly at higher loan-to-value ratios, has kept property transactions at a historic low of less than 600,000 a year. This is causing structural issues in the housing market, with lack of supply forcing rents up and keeping house prices artificially high. The government should extend the Special Liquidity Scheme and force the banks to redeploy capital to boost mortgage supply."
