April 24, 2013 1:25 pm

Lending schemes have made scant difference

By Jonathan Moules, Enterprise Correspondent

When it comes to the thorny subject of access to finance for small businesses, about the only thing everyone can agree on is that it was a lot easier before the financial crisis.

The various government schemes since then to encourage more lending seem to have made little difference.

There was the Enterprise Finance Guarantee, created in the dying days of the Labour government to provide guarantees on up to 75 per cent of a loan, then came Project Merlin, an agreement between the coalition government and Barclays, Lloyds Banking Group, the Royal Bank of Scotland and HSBC to promote lending to small businesses. The results of both were disappointing.

The Funding for Lending Scheme, unveiled by the Treasury and the Bank of England last July and extended on Wednesday, aims to boost credit creation by providing banks with cheap funds in return for commitments to lend to businesses. However, FLS failed to prevent a £2.4bn dip in lending in the fourth quarter of 2012.

Critics say that all these schemes are doomed because they have focused only on increasing the supply of credit when there are other problems that depress lending levels.

Henry Ejdelbaum's company, ASC Finance for Business, specialises in finding funding for small and medium-sized enterprises. He says there is a lot of truth in the banking industry's claim that there is a lack of demand for loans.

No government-backed lending scheme is going to change this, he says, because it is linked to confidence in economic prospects.

In addition to this, there are a number of hurdles companies must cross before they can access a loan, Mr Ejdelbaum adds. The biggest one is the valuation of the business, which is usually less than the owner thinks. Banks also ask for an abundance of information and this has cost implications, he says.

"Banks say that for a six-month project they want monthly reports from an accountant, which means the cost of the debt goes up," Mr Edjelbaum explains. "They then say: we don't want your accountant we want ours, or we don't want your quantity surveyor we want ours to supervise you."

David Kern, chief economist at the British Chambers of Commerce, criticises the government's decision to judge success on the amount of lending its schemes generate.

"The banks are being given conflicting messages, to rebuild their capital and at the same time to lend more," he says. "Until the banks rebuild their capital further, and become less risk averse, they will not resume adequate lending to creditworthy businesses."

Mr Kern is in favour of the new business bank, another recent government idea to increase access to credit by combining public funding and private capital. Such an institution will not be encumbered by past mistakes and should not be excessively risk-averse, Mr Kern says.

This is little comfort for those seeking finance.

Helena Hudson, who runs the Real Eating Company, a profitable chain of five restaurants and cafés in the south of England, was able to have the interest rate on her banking facility reduced by 1 per cent thanks to FLS. However, a reorganisation of her borrowing was forced on her after her bank, where she had been a customer for six years, insisted she reduce her overdraft facility by £50,000, while allowing her to increase her term loans by a similar amount.

"[The EFG] wasn't initially offered," Ms Hudson says, adding she is trying to increase her working capital now by offering higher-margin dishes to customers, rather than seeking more outside funding. "By the time you factor in for the reports needed to get the loan, it is quite an expensive exercise."

The difficulty the government faces with the Funding for Lending Scheme is that it is reliant on third-party involvement of banks, according to John Williams, managing partner of Kuber Ventures.

As a venture capitalist, he represents an alternative means of funding, whereby companies raise capital by selling equity stakes in the business. A big problem with government policy to date is that it fails to encourage more equity fundraising, according to Mr Williams.

"Alternative investment schemes where the government has influenced funding into small businesses directly via tax incentives have had much more of an impact in stimulating small business growth," he says.

He notes that tax breaks for equity investments, such as the Seed Enterprise Investment Scheme, can help business owners access funding. HM Revenue & Customs has received more than 1,000 applications for SEIS investment since its launch last summer, he says.