Deals

FINDING FINANCE • CREDIT INSURANCE

HOSTAGE TO FORTUNE?

With many banks preferring to say no to financing businesses, directors are desperate to find new forms of finance. **Tim Evershed** and **Kurt Jacobs** examine some of the alternative sources available

The nice man at the bank smiles a nice smile, nods an understanding nod, but still refuses to give your businesses the money it needs to keep going. "I'm sorry," he says. "It's not me but the credit committee says they would rather not."

As the credit crunch continues cash remains a scarce commodity, so finding and securing capital has become paramount for all enterprises. So what alternative public schemes and private initiatives are there to help get businesses through times of crisis?

The majority of public finance schemes are available through the regional development agencies Advantage West Midlands (AWM) and the East Midlands Development Agency (Emda), which are busier than ever as they respond to the downturn.

Jonathan Lowe, head of business investment at Emda, says: "Pre-dating the credit crunch are various funding sources, which we've set up over the past seven or eight years, but we've also been busy over the past few months responding to the credit crunch."

The RDAs have highlighted two major grant schemes available to companies in the East and West Midlands. The Grant for Business

Investment aims to encourage small and medium-sized enterprises (SMEs) to invest in land, buildings, plant and machinery, while the Grant for Research and Development (R&D) awards support the development and commercialisation of new technologies.

"It's about supporting innovation. People make the mistake of thinking they have to demonstrate that their R&D project is low risk, but it's actually about us supporting and mitigating a high-risk investment in developing a technology, in a way the private sector would find hard to justify," says Lowe.

Patrick Palmer, head of Access to Finance at AWM, says the number of businesses accessing the Community Development Finance Institutions (CDFIs) initiative more than doubled in 2008 as capital from traditional sources dried up.

CDFIs provide loans of up to £50,000 through providers, under the umbrella of the Fair Finance Consortium, to small businesses that cannot access finance. In addition, AWM says The Advantage Transition Bridge Fund, which lends between £50,000 and £250,000, is receiving more applications.

Palmer adds: "We're keeping the total in that fund under review and will top it up if necessary. The Enterprise Finance Guarantee is intended to get the banks lending and hopefully take the pressure off the transition fund."

Businesses that qualify will be those "where their inability to access mainstream finance is impeding the company or preventing them operating", says Palmer, adding that "a viable business plan and a management team capable of delivering it" are crucial.

"The most important issue is to show where your turnover is coming from and how constant it is. Forecasts should be based on explicit conversations with customers and how low they think sales could fall."

Emda is behind the £5m East Midlands Transition Loan Fund. It was launched in February 2009 and lends up to £250,000 to businesses unable to access bank finance.

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Lowe says: "Interest is charged at a level over base rate as it's designed to address the availability of finance rather than cost. This should be the last port of call. This isn't about bailing out businesses but addressing finance issues."

Because of European Community rules areas, sectors as agriculture, coal, steel and shipbuilding are exempt from these schemes: rather they are focused on manufacturing, bioscience and healthcare, food and drink, construction and transport equipment.

Emda is supporting the Enterprise Loans East Midlands scheme that lends between £3,000 and £20,000, and which was set up in response to demand from small companies the banks were not financing.

Lowe says: "RDAs are in new territory. They were never intended to take the place of banks. We're looking to address – in a fairly modest way – the failings of the market, but

PUBLIC FUNDING OPTIONS IN THE MIDLANDS

SCHEME	RANGE (£,000)
ADVANTAGE EARLY GROWTH FUND	£20-£100
ADVANTAGE ENTERPRISE & INNOVATION FUND	£250-£1M
ADVANTAGE GROWTH FUND	UP TO £250
ADVANTAGE PROOF OF CONCEPT GRANT FUND	UP TO £30
ADVANTAGE TRANSITION BRIDGE FUND	£50-£250
CATAPULT GROWTH FUND	£500-£2M
COMMUNITY DEVELOPMENT FINANCE INSTITUTIONS	UP TO £50
EAST MIDLANDS EARLY GROWTH FUND	£30-£200
EAST MIDLANDS TRANSITION LOAN FUND	£50-£250
ENTERPRISE LOANS EAST MIDLANDS	£3-£20
GRANT FOR BUSINESS INVESTMENT (EM)	UP TO £140
GRANT FOR BUSINESS INVESTMENT (WM)	£10-£2M
GRANT FOR RESEARCH AND DEVELOPMENT (EM)	£5-£250
GRANT FOR RESEARCH AND DEVELOPMENT (WM)	£5-£50
LACHESIS FUND	£5-£250
MERCIA TECHNOLOGY SEED FUND	£50-£750

we need to be realistic about the extent to which an RDA can solve a banking crisis."

Business Link should be the first port of call for any business planning to access these funds, according to the RDAs. It will be able to help companies get in touch with the right fund and advise on the application process.

Anthony Andrews, head of access to finance at Business Link, says: "Before you make a decision you need all the information. You need to talk through the issues with an adviser and form a plan. Presenting a better case, with experienced personnel, is vital, as are monthly management figures. A full order book used to be enough, but not anymore."

Business Link can contribute up to half the cost of consultations and made 50 grants in the 2008/09 financial year. The organisation is also running workshops and seminars in both regions and has produced a "How to…" series of guides with advice on managing cash flow, saving money on suppliers and dealing with redundancy.

These schemes are just some of those on offer in the Midlands. There are also a number of venture capital (VC) options available.

Lowe says: "It's a harsh fact that VCs invest in just one-in-a-100 opportunities, but improving that rate is about increasing the capabilities of businesses. This could be through improvements in networking or improving the quality of the pitch."

Graham Mold, director with Midlands-based Catapult Venture Managers, adds: "We're still doing deals and so too are other private equity players in the market. Money is definitely in the pot for the right businesses.

"Some well-run businesses are finding overdraft limits cut, leaving them exposed through no fault of their own. In the harsh environment there has to be a sense of realism by owners as to the valuation placed on their businesses and projected growth."

FAIRER FINANCE

A number of organisations have been set up in the Midlands in the past ten years to support enterprise by lending to businesses the banks have turned away, or been unable to help fully. These are independent, not-for-personal-profit lenders, supported by the public and private sectors.

They often lend with banks and other lenders, making up the last part of a financial package. They lend between £3,000 and £50,000 to businesses in most sectors, although some lend smaller amounts to encourage start-ups. The money can be used for help with cash flow, marketing support or investment in equipment or staff.

Most take a personal approach to risk assessment so poor credit history, lack of assets or security need not be a barrier. In the East Midlands they work under the Enterprise Loans East Midlands banner, while in the West they are known as Community Development Finance Institutions (CDFIs). In the past few weeks the connections between the CDFIs have been formalised as the Fair Finance Consortium, covering the whole region.

Aston Reinvestment Trust, which targets Birmingham and Solihull, has lent more than £6.5m to more than 300 borrowers in the past decade, enabling them to create or preserve nearly 3,000 jobs.

Chief executive Steve Walker says: "It's frustrating that the message still has not reached more people that it is possible to borrow from alternative, reputable, lenders if the banks say no."

Regional equity investment schemes work on a matched investment basis and business angels tend to be the most popular and traditional source. While there have been reports that business angels are "keeping their hands in their pockets", Andrew Durban, partner in the corporate finance unit at accountancy firm Smith Cooper, says investors are still "banding together to raise capital".

He adds: "Due diligence is tougher and more questions are being asked. It's about checking the projections and challenging the delivery of those projections, especially if the business was to lose a key customer. There's more of a defensive strategy and a requirement to be pessimistic about prospects."

There are, allegedly, some green shoots of recovery for bank lending. In February 2009 The Royal Bank of Scotland announced a £250m fund for SMEs in the East and West Midlands; Barclays Bank in Birmingham says it is sanctioning four out of every five small business plans submitted; while The Co-operative Bank appears to be the institution most pundits claim is still open for business.

Durban adds: "There's much less lending than nine months ago. We look at the overall finance requirement, the individual parts and how they can be solved. Asset-based lending (ABL) funding is out there, and stock financing and invoice discounting is still an option."

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Peter Flynn, commercial director at Close Invoice Finance, says: "Invoice finance is just as available as it always has been because the credit and debt it is worked from is still there and our criteria has not changed."

Sources say lenders are generally keen to see opportunities involving oil, gas, public finance initiatives (including education, health and waste), recruitment agencies and franchises for fast-food chains. Commercial property, the automotive industry, house-building and retail are all perceived negatively, although there are niche lenders out there.

Birmingham ABL house Moneyway is still providing finance for the motor industry while Bibby Financial Services retains its appetite for construction with a fund of £30m per year available. Jason Heath, product director Construction Finance, Bibby Financial Services, says: "Everyone's a bit risk averse at the moment. What you cannot do is tar everyone with the same brush because there are fundable businesses out there." ◗

VENTURE CAPITAL VENTURES OUT

Venture capital and private equity have not done much venturing out of late, but according to pundits in the sector that may be about to change.

Mark Advani, partner at Isis Equity Partners, says: "Many private equity (PE) houses are clinging to the hope that leverage will soon return and until then they only have half the money they need to complete acquisitions. We don't expect leverage to return for some years, so we have developed equity-only products to do it ourselves. As long as debt remains scarce a canny entrepreneur will need to focus his or her efforts on PE houses that can fund the whole deal."

Paul Franks of Gresham private equity is also of the "let's go it alone school", saying: "We have the ability to underwrite the debt in deals up to £40m, which enables us to get deals done irrespective of the banking climate."

However, the general opinion among dealmakers is that the biggest brake on private equity's funding of business has not been access to finance alone, but a mix that has included uncertainty in the market and venture capitalists waiting to call the bottom of the market.

Rob Carroll, of Catapult Venture Managers, says: "People are naturally cautious. I think PE and venture capital houses are no different in this regard. But we live in an interdependent world where you can't simply shut up shop for six months. We have to emerge at some point, and while opportunities may be cheaper tomorrow, they may not be available tomorrow."

The state of the economy may also play into the hands of SMEs in other ways: mega-deals – those transactions with a silly number of noughts on the price tag – seem to be at an end, so PE houses are focusing on mid-market investments.

Chris Hurley, investment director at LDC, says: "Despite the downturn there's still a strong appetite to nurture and support businesses in the Midlands. Although the market is more difficult, it is active.

"At the larger end 2009 will be more challenging as the unstable economy is unlikely to support high-value, debt-laden transactions. The mid-market, though, should be more upbeat as private equity providers still have funds to support the right businesses at the right valuation."

Franks adds: "The slowdown at the end of 2008 reflected a lot of uncertainty in the economy but an unwillingness by vendors to accept the values of their businesses. Now pricing has moved to a point where deals can resume again."