BANKING ON A LOAN

HOW CAN COMPANIES AND THEIR ADVISERS CONVINCE BANKS THAT THEY'RE SOUND? LIZ LOXTON INVESTIGATES

Good news – the manufacturing sector has eased itself out of recession according to the Chartered Institute of Purchasing and Supply, and the service sector too is showing signs of recovery. With manufacturing output up 3.4% in April 2010 compared with April 2009, order books are beginning to fill and businesses that have weathered the storms of recession, often depleting their reserves in the process, will be squaring up to the challenge of funding new orders and their own individual recoveries.

Who will supply their working capital, expansion or refinancing requirements? British Banking Association figures for commercial lending, drawn from the seven largest UK retail banking groups, suggest that debt finance has yet to pick up in any meaningful way. Lending to companies for April 2010 was £12.2bn, an improvement on the monthly average – £6.6bn – for the previous half-year, but still a very subdued picture.

Denis Kaye, director of management consultancy Firm Ideas, says he sees few signs that the market for

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bank lending is much better than a year ago. Banks, he says, are taking longer to decide on loans, rates are high – typically 8-9% over base rate compared with 2-3% a few years ago – and terms difficult to negotiate. 'Banks declare they are open for business, then prevaricate,' he says. 'Decisions don't come out on a timely basis.'

Others say that the situation is finally easing but argue that the going will remain tough for a while yet. Ali Aneizi, corporate finance partner at Baker Tilly, says availability of loan finance has improved in recent months, although factors such as troubled economies in the eurozone may cause renewed nervousness among lenders.

WHO AND HOW?

Success in acquiring loan finance depends on two factors: who you ask and how you put your case. Dougald Middleton, head of capital and debt advisory at Ernst & Young, says there is appetite on the part of the banks to roll out credit with existing borrowers. 'Unknown names and SMEs, if they put together a cogent case, should also be able to get finance,' he says.

Aneizi points out that Lloyds and RBS, in return for the public money bail-outs they have received, have made commitments to government on lending, while new entrants, such as Santander and Clydesdale, are looking to win market share.

Lindsey Rix, regional managing director for Santander corporate banking for London and the South East, says the bank is looking at requests from new names, interested in forging relationships and looking at requests on a case-by-case basis. 'Some businesses will have had trials and tribulations, we understand that,' she says, 'but we are looking to also understand where they want the business to go, as well as how they have responded to those issues.'

But Kaye believes that borrowers are going to have to do more to make successful applications for loans in terms of what they are prepared to offer up as security, and that bankers are falling back on old-school disciplines. 'I'd like to be able to say that it is all about the credibility of the borrower. Sadly, bankers seem to have reverted to looking at security above all else. So they want charges over assets and they want personal guarantees. They will also need to see cashflow to service the borrowing but they are less willing to do pure cashflow lending without real security.' That can pose difficulties in a business environment where more and more assets are leased rather than fully-owned.

So how can companies and their advisers convince banks of their soundness?

Rix says that Santander prioritises understanding of the overall business, its strategy, management team and competitive environment, over a dash into the numbers. That said, audited and management accounts and cashflow projections are undoubtedly important and it is for sensible management to be able to provide that visibility, she says. But an examination of those tends to come later in the process.

There are three important elements, says Aneizi: constructing a good business plan; demonstrating that you have a committed and talented management team; and showing you have a strong finance function that has robust procedures and is capable of reporting accurately on the state of the business.

When it comes to convincing a bank that a company is a sound prospect for lending, proper attention needs to go into the work of constructing the business plan, says Aneizi. 'The business plan is your shop window and needs to be put together with care. It should reflect a sense of professionalism, it should be robust and based on realistic assumptions that will stand up to due diligence. Lenders are largely driven by cashflow, and anybody looking to borrow from commercial lenders needs to spoon-feed them as to how cashflow is generated and be clear on where it is likely to come from.'

Demonstrating that the business is in capable hands is also important, says Kaye: 'Borrowers need to establish credibility, which means having a proper management team with expertise in all functions – not just a group of sales or production people with a good product/service.'

EXPERTISE AND SKILLS

Aneizi agrees. It is crucial to demonstrate to lenders that the management team has the expertise and skills to deliver on the business plan, but also, deal with changing economic conditions.

Clear financial information presented simply is a must, says Denis Kaye. 'While the underlying models may be quite elaborate, it is important to be able to present an overview in the executive summary that can be readily understood in a few minutes.' It is also important that the information is 'stress-tested' and that the management team can demonstrate that they have considered how they will service their debt if sales are lower than anticipated or costs are greater. 'It's a return to common sense. You need to put yourself in the shoes of the other person. The bank manager is looking for comfort.'

And while it may be advisable to avoid information overload, would-be borrowers should also make sure that they let the banks have the full picture about their competitive environment or pressures on their business. It is important to be open and transparent if you are to build trust on both sides, says Rix, as no one likes surprises.

LENDING SUCCESS – TOP TIPS

Business plan – put together a full and professional business plan that helps the lender understand where expansion and cashflow will come from, and one that shows that the management team has tested its own assumptions on sales and costs

Align your interests with the lender – especially in owner-managed businesses, lenders like to see that the people involved are prepared to risk their own money

Show that you have expertise – the management team needs to be experienced in a range of disciplines, not just one or two