

The Graham Review of the Small Firms Loan Guarantee Scheme

Response submitted by East Midlands Development Agency on behalf of the East Midlands Regional Risk Finance Forum

2. (i) Does the structure of SFLG mean it is a valued option for decision-makers in the lending institutions? Does SFLG address the right problems in the market, i.e. those that matter to lenders and borrowers, and thus form an important part of the commercial decision-making process? Are there changes that might be made to increase the incentive for lenders to use SFLG in appropriate circumstances?

The scheme is generally regarded as a valuable tool to enable banks to support propositions which otherwise would have been declined due to lack of security. The additional qualifying sectors introduced to the scheme in April 2003 have enhanced its value, and anecdotally have led to an upturn in scheme lending.

Feedback suggests, however, that the scheme continues to fall short of its full potential due to an unwillingness on the part of DTI and SBS to encourage businesses to initiate discussions with lenders; a perception (amongst some businesses and indeed amongst some individual lenders) that the scheme is 'bureaucratic'; a lack of proactivity on the part of banks to promote SFLGS lending given that it represents a small percentage of their portfolio in both actual and potential terms. This is especially marked amongst the retail/business banking community.

A number of regional contacts also feel that currently some of the scheme criteria are not clearly defined, leading to differing interpretations amongst lenders.

With regard to incentives, lenders should be given greater flexibility on pricing for small SFLG loans to encourage them to use the scheme more proactively in achieving volume and income growth.

2. (vii) Is it common for SFLG loans to be used as part of a package of finance? What type of businesses might use SFLG in this way, and what role does SFLG play in these deals?

Yes – corporate finance teams use SFLG regularly as part of a package of transactional finance. SFLG has also helped to leverage investments by the Regional Venture Capital Fund in the East Midlands

Usage is common in assisting start-ups (including 'phoenix' companies), although the maximum SFLG loan of £100,000 is regarded as too low, given that new businesses are generally under-capitalised and under-funded.

2. (xi) Are there any changes to the current structure of SFLG that could be made to improve the impact of SFLG in assisting businesses that otherwise could not access finance?

Suggested changes include :

- Amending the criteria relating to available security – for example, there is

variability in lenders' interpretation of the availability of a jointly-owned property. In addition, more potential entrepreneurs could be attracted to the scheme if, for example, it was only a requirement for half a director or partner's available security to be charged.

- Removing or amending the restriction on 'repeat' applications – there appears to be little justification for preventing a further SFLG application if a previous loan has been repaid.
- Allowing greater flexibility on the purpose of borrowing – for example, to allow a partner to purchase a fellow partner's share in their business.
- As part of the SFLG application, permitting businesses to receive assistance for business support and advice, thus mitigating the risk of early business failure. This would clearly require a business to 'prove' that part of the loan was used for this purpose, but accountants or Business Links could potentially play a part in this process given the obvious benefits to them also.

3. (iii) A number of respondents proposed raising the current £30,000 limit above which lending institutions must get approval from the SFLG unit of the Small Business Service. Would borrowers and lenders welcome such a move, and, if so, what should the limit be?

This is a highly relevant question for many regional partners. Since the introduction of additional qualifying sectors last year, with a resultant increase in applications, it is evident that timescales for SBS sanctioning have become protracted. For SMEs and their advisors, an approval timescale of 4 to 5 weeks is unwelcome, and an increase in the lenders' delegated limit would doubtless improve this situation.

An increase in the limit to £100,000 – with perhaps different levels according to the business sector and perception of risk – is recommended.

3. (iv) Are the maximum loan amounts of £100,000 for new and £250,000 for established businesses still consistent with the aim of targeting those businesses with most need for a guarantee?

The maximum loan amount for established businesses is set at the correct level, but as stated in 2. (vii), the limit for new businesses is limiting the potential impact of the scheme.

Summary of views

Overall, the view of East Midlands partners is that SFLG is a valuable mechanism to encourage business growth amongst viable companies.

It is clear, however, that businesses, their advisers and lenders would benefit from improved awareness of the scheme, greater clarity in scheme criteria and increased responsiveness in the approval process.

There are also capacity and skills issues which would benefit from a wider review. Evidence suggests that as a result of structural and process changes within a number of the retail banks – for example, the introduction of credit scoring decision-making and a reduced emphasis on individual lending skills amongst small business bankers – there is a lack of knowledge of the scheme and, to a degree, a reluctance to promote it to small business customers.

However, if pricing flexibility could be introduced to incentivise the retail banks to devote more resources to promoting the scheme, this would greatly enhance its effectiveness.