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Dear Teresa

GRANT THORNTON SUBMISSION TO THE GRAHAM REVIEW OF THE SMALL FIRMS LOAN GUARANTEE SCHEME

Thank you for your letter of 23 February. As a leading adviser to the entrepreneurial business sector with offices across the UK, our partners have been involved with the Small Firms Loan Guarantee Scheme ("SFLG") since its inception in 1981.

We believe that the SFLG does provide an opportunity for businesses to obtain finance where they have difficulty demonstrating collateral to support other financing means.

However, a number of Partners have identified their experience of issues that could be addressed in order for the SFLG to fulfil all its' aims and outlined below are some of the firms thoughts for consideration as part of the current review process.

UNDERSTANDING THE MARKET

Given the context in which the SFLG now operates, and the diverse array of finance available to businesses today, there are issues that could be considered if the SFLG is to be recognised as a finance provider to the SME sector. In particular:

- one of the most significant developments in recent years in SME finance has been the change in acceptability of asset-based lending, Venture Capital Trusts and "hotbed" type offerings
- other developments within the market that need to be appreciated include the growth of the factoring and invoice discounting sector and the changing cultures within the banking sector as a result of the various bank mergers

- over the past decade the availability of debt finance for SMEs in general has not improved although there is a greater variety of sources of finance now available to the sector. In fact, commercial lenders appear to be applying stricter lending assessments, especially for "non-standard" cases.
- some parts of the SME sector remain unattractive to financiers - these include start-ups, phoenix companies and directors, new technology businesses
- the use of scoring systems to reduce banks' reliance on collateral is less significant than the realisation that it is profits and cash that service and repay debt. In fact, the use of scoring systems does not appear to have stopped the banks wanting collateral. Enforcement of security and the quantum realised from SMEs in the 1990's was a wake-up call for the banks
- the many forms of finance and suitability to specific situations can be confusing to smaller SMEs. The debt lender can also refer the customer on to these other forms as a means to avoiding the decision to lend or not.

UNDERSTANDING HOW THE SFLG IS USED TODAY

As it is broadly designed, the SFLG does play a valued and important role but there are ways that the uptake could be encouraged:

- bankers are heavily targeted and there can be a tendency not to bother with smaller loans. Lenders tend not to actively promote the SFLG and it is often reluctantly delivered on request
- the SFLG is widely known but more education might help. Additionally, the timescales needed in order to put a facility in place can also be unacceptably long
- with all the main banks participating in the SFLG, and the market share they collectively have, widening the number of lenders is unlikely to stimulate demand and it could be counterproductive to introduce new lenders unless the quality of loans approved by such lenders can be assured
- the market perception and uptake of the SFLG is very much at the start-up end of the growth cycle
- it is not surprising that the number of smaller loans is declining since they may be seen by the banks as uneconomic and time consuming to introduce, added to the fact that £30,000 does not go very far in the current business environment
- the SFLG is common in start-up situations where it can be part of a package, such as to provide initial working capital until book debts build sufficiently to be financed by other means (e.g. factoring)
- one change that could be introduced to the SFLG is to provide a link to external advice/support for businesses without a previous track record. The cost of such

advice could be met in whole or in part by the SFLG facility or by imposing a condition that advice be sought from an approved provider/Business Link/Chamber of Commerce as part of the finance being made available. This could provide stronger links within local business communities and help to reduce the incidence of early stage business failures

- the one change to increase the take-up by lenders and availability for business would be to increase the Government guarantee rate. Arguably, if the Government wants to increase funds available to early-stage and start-up operations, this guarantee should be nearer 100%

DELIVERY AND ADMINISTRATION OF THE SFLG

This is an interesting area as there appears to be the need to consider introducing greater clarity in respect of certain aspects of the SFLG:

- the interpretation of availability of a marital home is always a grey area and care should be taken to ensure that the banks are not tempted to tighten their security criteria following developments in the "Brumark" case. Personal assets need to be treated sensibly, but not excluded from the definition of available assets
- there have to be thresholds for the SFLG but those with most need are not always defined in amount terms. Another way to determine the appropriateness of the sum may be to ask supplementary questions to determine the loan amount based on need.

For example, the limits quoted could be exceeded for applicants who:

- are prepared to take a higher level of personal risk/responsibility
 - have recognised business experience/qualifications
 - are willing to use external sources of support/advice
 - operate in an industry sector where failure rates are historically lower
- with regards turnover criteria, it might be simpler to raise the maximum limits to c£5 million for all applicants and thus simplifying the scheme. This would be in line with recent changes to small company criteria on turnover as defined by Company Law.

OTHER ISSUES

The continuing role of the SFLG could be enhanced by clearer communication to the business community, clarifying the role of the scheme for business and therefore by increasing awareness of the scheme there may be increased penetration of the SME sector.

One of the main concerns with the current scheme is the administrative burden taken to process an application and the time taken, which given the technological advances that have

been made in the years since the SFLG was introduced could be addressed via some form of web-enabled process.

We recognise the role that the SFLG has in the current business environment and welcome this ongoing review. I trust that the above information is useful for the purpose of this review and would like to highlight that the points raised above represent a small sample of partners who have clients who have used the SFLG that were available to comment on their experiences, in the time available. Please do not hesitate to contact me if we can be of any further assistance.

Yours sincerely

Michael Cleary

National Managing Partner