



**Response to Graham Review of Small Firms Loan
Guarantee Scheme**

Ulster Society of Chartered Accountants in Ireland

April 2004



Graham Review of Small Firms Loan Guarantee Scheme Comment by the Ulster Society of Chartered Accountants

1 Introduction

1.1 The Ulster Society of Chartered Accountants is pleased to respond to the Graham Review of Small Firms Loan Guarantee Scheme (SFLGS). The Society represents some 2,200 chartered accountants working in practice, in industry and in the voluntary and public sectors.

1.2 The Ulster Society first commented on SFLGS in its report ‘Financing for Growth’ commissioned by the then Industrial Development Board for Northern Ireland and the Local Enterprise Development Board (now subsumed in Invest Northern Ireland) and produced in June 2001. We believe that it is worth recalling here our main findings on the workings and uptake of SFLGS. That Report highlighted that there was “a significant under-utilisation in Northern Ireland of SFLGS when compared with the uptake in other regions of the United Kingdom”. The six reasons suggested were:

- (a) lack of awareness of SFLGS among SMEs;
- (b) reluctance of banks to promote the Scheme;
- (c) availability of personal security outside of the business as an alternative to SFLGS;
- (d) the residual risk exposure to banks (currently 25%) may be considered too high;
- (e) the interest rate charged is usually higher than normal;
- (f) the administration process, which is reportedly fast, efficient and straightforward, requires documentation to be approved by the Small Business Service.

1.3 The Report also made four suggestions to increase the frequency and uptake of loans under SFLGS:

- (a) government, accountancy bodies, banks and SMEs should work together to raise awareness of SFLGS among Northern Ireland’s small businesses;
- (b) government and accountancy bodies should work more closely with the banks to identify ways in which the Scheme can be simplified for the banks and SMEs;
- (c) given that the Northern Ireland economy and the uptake of SFLGS both lag behind the rest of the UK, the 25% banks’ exposure could be waived to say 10% for a period of 2-3 years;

(d) In order to broaden the scope of SFLGS, the qualifying loan ceiling could be increased to £500,000 in line with 'soft loans' available in other countries such as in Australia and the Netherlands.

1.4 Three years on, the Ulster Society believes its comments, both in terms of the shortcomings of the Scheme and our recommendations, remain relevant.

Findings

2.1 One of the most significant developments in recent years in SME finance would be the emphasis on cash flow lending by the banks and an increasing trend towards the introduction of "outside" private equity. Northern Ireland still remains a laggard in its take-up of SFLGS. Compared with Wales, with 250 loans in 2003, Northern Ireland should have had a similar number of loans under the Scheme whereas the figure was only 34. Scotland, with three times the population of Northern Ireland, had 578 Scheme loans.

2.2 It may of course be the case that there are cultural reasons for the low take-up. It has been noted elsewhere that Northern Ireland has a disproportionately low number of entrepreneurial start-ups compared with other UK regions (although this is being aggressively addressed) and a resistance among small and family-owned companies to utilise venture capital or sharing of equity. Similarly there may be an endemic reluctance to consider paying a premium on interest rates to secure a loan under SFLGS.

2.3 There is also evidence of widespread ignorance among Northern Ireland companies, whether fledgling or mature, about the existence, never mind the nature, of SFLGS. Such ignorance is not helped by the reluctance of the banks to promote the availability of SFLGS. In the overall scheme of financing a business a loan under SFLGS tends to be only one item in the company's debt portfolio taking its place after asset backed finance, leasing and overdrafts. In making their lending judgement the banks rely upon the quality of the relationship, the track record and the professionalism of the business plan as well as the security offered. Lending sums of £100,000 (the limit for companies with a trading record of less than two years) involves disproportionate administrative costs to the bank which are not compensated for by the higher interest premium. Not surprisingly, banks have preferred to steer clients to more conventional financing arrangements. On the other hand the influx of overseas banks and overseas ownership of former local banks as players in Northern Ireland has improved the competition for lending.

2.4 There is therefore little doubt that the availability of debt finance for SMEs in general has significantly improved over the past decade.

- 2.5 Where there has not been as significant an improvement has been in the three areas indicated ie start-ups, firms with non-standard applications and entrepreneurs associated with failed enterprises. The anecdotal evidence in this area however conflicts. For example, intellectual property requires considerable financing and should be looked upon more favourably, particularly as the Northern Ireland manufacturing sector declines, however debt finance can still be difficult to obtain. Yet evidence can be quoted of software being acceptable for asset finance where previously such an asset would have been considered to be an intangible asset and therefore providing no security for banks. Perhaps it is in these very areas that the SFLGS could prove to be the most beneficial to SME's.
- 2.6 We have no real evidence of a growth in scoring systems being applied (although this may be true of personal banking). We would not support such a mechanistic way of interacting with businesses. Northern Ireland is a small marketplace with little anonymity and banks can be expected to place more emphasis on relationship criteria.

Conclusions

- 3.1 The Ulster Society believes that the SFLGS should be relaunched with an education drive among the accountancy bodies, the banks, SMEs and Invest Northern Ireland on the availability and value of the SFLGS. Particular emphasis should be placed on a quality professional business plan supporting the application in order to ease the administrative obligations of the bank.
- 3.2 The Ulster Society believes that for the scheme to provide real benefit to SME's in Northern Ireland it also needs to be revamped so that its upper limit is increased to £500,000 and the restriction on re-availing of the SFLGS should be dropped as this penalises success and prevents or slows growth. Invest Northern Ireland should incorporate the Scheme's availability including its administration in their overall portfolio of assistance packages.
- 3.3 The Ulster Society believes that by accepting the above measures, in particular the implementation of an awareness raising programme focusing on the potential value of the scheme, the perceived benefit of, and the image associated with, the SFLGS can be significantly enhanced within the business community.