NICVA CEE Masterclass

Making Banks Work - Getting growth finance going

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Agenda

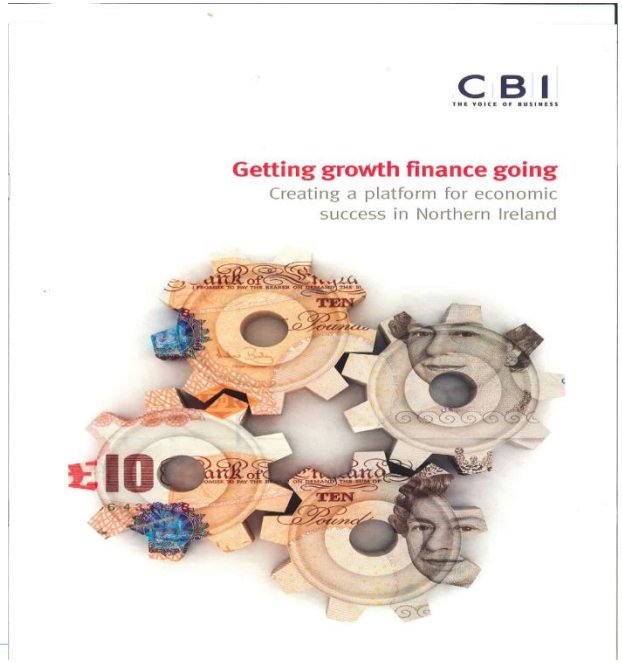
- **Background and Context**
- **Supply and Demand issues – key trends**
  - A very shaky economic backdrop
  - Lending has not stopped but the bar has risen
  - The flow of venture capital is patchy
  - Overall funding landscape not geared for success
  - Businesses themselves must do more
- **Recommendations**
- **The national picture**
- **Top ten priorities and progress to date**
- **What does this mean for a business?**
- **Concluding comments**

Background

- **Recognised as priority issue by CBI NI Council in 2011**
- **Not solely a Northern Ireland issue but we have some unique circumstances – structure of economy, bank ownership, property boom/bust, etc**
- **Task and finish group established – chaired by Ian Coulter**
- **Extensive consultation**
- **Aim to identify key issues and offer practical steps to mitigate the funding challenges**
- **Increasing crisis in Eurozone not helping – the issues/challenges are not a short-term issue**

Northern Ireland situation

- **Getting Growth Finance Going launched in June 2012**
  - Context
  - A shaky economic backdrop
  - Bank lending has not stopped but the bar has gone up on risk (with lenders now prizing cashflow over assets
  - Flow of VC is patchy, lacking a continuum and often stop/start
  - Overall funding landscape not geared for success
  - Businesses themselves must do more to become funding ready
    - Limited appetite for risk
    - Aversion to equity
    - Poor finance proposals
- **Extensive range of engagements with stakeholders**



Context

- **Stock of lending across the UK has been falling**
- **Recognise many small businesses not seeking finance**
- **Success rate for bank lending has fallen sharply – in NI 92% to 65% - though including partially successful applications the trend is 97% to 83% (treat figures with caution)**
- **SMEs less likely than GB counterparts to approach banks for finance (may in part reflect economic circumstances)**
- **SMEs – strong reliance on traditional financial products**
- **Debate on the causes of the financial gap continues – mismatch supply/demand**
- **Unless sufficient finance available, on acceptable terms, growth and job creation will be significantly constrained**

Supply and demand issues – key trends

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- **A shaky economic backdrop**
  - Emerging from a deep recession
  - Many SMEs getting their house in order – paying down debt
  - Deposits increasing – though NI banks are still not self-funding
  - Economic outlook subdued and unpredictable – little growth – and much uncertainty, especially within Eurozone – UK expected to grow 1% in 2013 and 2% in 2014

- **Bank lending has not stopped, but the bar has gone up on risk**
  - New capital adequacy requirements and tougher banking regulation
  - New and more rigorous ‘assessments’ of applications by banks
  - Lenders prize cashflow over assets - lenders need confidence that debt can be serviced
  - Overall a much more riskier picture
  - Larger organisations have stronger financial capabilities and are generally more attractive propositions than SMEs
  - Mismatch between supply and demand
  - Some recent interventions – but UK schemes have had limited success in NI and scale of funding challenge should not be underestimated

Supply and demand issues – cont'd

- **Flow of venture capital is patchy**
  - Health and continuous supply of equity finance is central to achieving a high value knowledge based economy
  - VC activity in NI is limited: small in size relative to Scotland/ROI; market lacks vitality and dynamism – limited competition, funds limited to NI, incentives too narrow
  - Lack of continuum and availability of funding has been a real issue
  - Gaps at early stage, the 'middle corridor', and £1m+

- **Overall funding landscape not geared for success**
  - Growth oriented SMEs struggle to find a path through a complex funding landscape
  - Need better advice, signposting and connectivity
  - Too many sell on too early – too bruised to consider another round of funding
  - Learn from other successful regions regarding their funding strategies
  - Issues at national level too eg develop a bond market

Supply and demand issues – cont'd

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- **Businesses themselves must do more to become funding ready**
  - **Limited appetite for risk**
    - Too many firms too insular
    - Risks in non-core ventures eg property market now hampering existing business
  - **Aversion to equity**
    - Historically a reluctance to consider diluting shareholding
    - Limited demand has stunted supply
    - This will have to change as 'equity gap' develops over the next five years
  - **Poor finance proposals**
    - Weaknesses in business proposals – too often businesses are not clear enough on how debt will be serviced
    - Often short on structure, too heavily skewed towards asset-based requests or those backed by personal guarantee
    - Approvals closely related to using an external financial advisor

Recommendations

Understanding the Problem – key priorities

- **The Executive must get more accurate live data on the scale of the funding gap and current lending trends**

- **The Executive's 'Access to capital' strategy should be updated to take account of recent developments**

- **Other**
  - DETI should establish a 'liquidity group'

Information needed to develop a clear and specific strategy to counterbalance the liquidity issues

Recommendations (cont'd)

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Treatment – key priorities

- **Executive - Allocation of additional funding of c £25-30m pa**
- **Executive - Greater budget flexibility for Invest NI**
- **Banks – encourage introduction of longer-term lines of credit**

- **Other priorities**
  - Lobby for new NLGS to be customised for NI (and any new funds)
  - New Growth Loan Fund should aim to lend at lower end of 8-12% range – encouraging demand emerging
  - NILGOSC – review how to increase their investment in NI
  - DFP/DETI – review with ROI government how 'all-island' funds can be maximised
  - Executive – review with NAMA how 'vendor-financing' packages can be introduced in NI

Recommendations (cont'd)

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Rehabilitation – key priorities

- **Executive – need to develop a funding continuum – with greater standardisation and new deal structures should be designed to reduce costs and increase the attractiveness of VC**
- **Invest NI – consider how SMEs can be supported to build better financial capabilities – creation of a 'financial voucher'**
- **Other**
  - New diaspora strategy
  - Invest NI – consider whether incentives could be introduced to encourage alternative financing solutions (LEDU previously used)
  - Executive/DETI/Invest NI – liaise and work with BIS re Breedon review and development of bond market
  - Executive – establish taskforce to develop action plan – EAG report imminent- lets get on with some action now!

Not just a Northern Ireland problem

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CBI - Financing for growth - published July '12

Current lending situation showing signs of deterioration – pricing edging up, investment intentions remain weak, reports on constrained lending

Measures to smooth transition to 'new normal

- Ensuring financial regulation is fit for purpose
- Actively supporting areas of the economy that have seen bank lending retreat substantially eg in housing and construction (not available in NI)
- Working to ensure SMEs and MSBs lending propositions do not fall through the net – raise awareness of alternative sources of funding – eg a 'one stop shop' approach
- Take action to overcome substantive wave of refinancing over next four years

Refocus approach to ensure financing is aligned to support re-balancing of economy

- Urgent implementation of measures to support high growth MSBs eg tax allowances for raising equity finance, EIS expansion, introduction of Bond products
- Clear focus on boosting exports by shaping trade financing regulation, coupled with new products to support UK exporters – range of technical issues, new export fund to lend to buyers, etc
- New incentive to encourage large firms to get involved in corporate venturing

Northern Ireland - Focus on top 10 priorities

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- Co-ordination – NI Executive to appoint senior representative to lead on issue
- Better breakdown on lending information
- Regular forum between NI Executive and banks – need to be carefully managed
- Executive must commit an extra £25-30m annually
- Greater budget flexibility to Invest NI
- Common application forms and business plans (ROI leading on this)
- Introduce ‘finance vouchers’ – being piloted now
- Influence national loan schemes – ensure they reflect NI needs
- Introduce competition between VC funds – out for tender now
- Encourage banks to invest in/set up VC or mezzanine fund

Progress to date

- Stimulated a more informed discussion and debate – meetings/presentations/workshops – with good engagement with DETI/DfP/Invest NI
- Moved the issue up the Executive's agenda – EAG commissioned their own research – due to report shortly
- Invest NI launched in November two new tenders for VC funds with public funding of £15m committed to each fund (brings the funds available under Invest NI 'Access to capital' strategy up to £100m over next 6 years
- Invest NI to introduce 'Finance Vouchers' this quarter
- Continue to push for progress on other priorities
- Recent Developments
  - Ministers Foster and Wilson have had further round of meeting with all banks
  - CBI meeting with David Sterling, DETI on 30 January
  - DFP/DETI meeting on 31 January
  - CBI meeting with Secretary of State on 31 Jan (with insolvency practitioners)

What does this all mean for a business?

- Capital will be used more cautiously
- Companies will need to reduce their reliance on debt (UK – 75% of capital is debt funded, USA – 25%) – at present more companies paying down debt!
- Companies will have to retain more earnings (and reduce dividends)
- Need to review a wider range of financing options, including
  - From up/down supply chains (seeing some examples of this)
  - Medium/larger companies may try to move into Bond Market (less relevant in NI)
  - Look at VC or some forms of mezzanine finance
- Debt will still be important – but valid and accurate management account information will be critical
- Other forms of debt finance – invoice discounting, asset financing etc
- Maximise use of grants/ tax credits etc
- Companies will need to become more sophisticated

In conclusion

- Access to finance is a major constraint on growth and job creation – not just a short term issue
- Need proactive, political leadership – need information and understanding of what lending is going on, where are the gaps, and what intervention is required to support growth in the economy. Government and banks need to work constructively together
- Learn lessons from elsewhere – ROI – probably a couple of years ahead – proactive to addressing the challenges
- Practical issues also to be addressed – better information/awareness on alternative financing options, simplification/standardisation of loan application forms etc, enhance financial capabilities of SMEs
- Companies must realise the world has changed – and need to be prepared to change themselves

Thank you

CBI NI's '*Getting Growth Finance Going*' report available from www.cbi.org.uk/ni