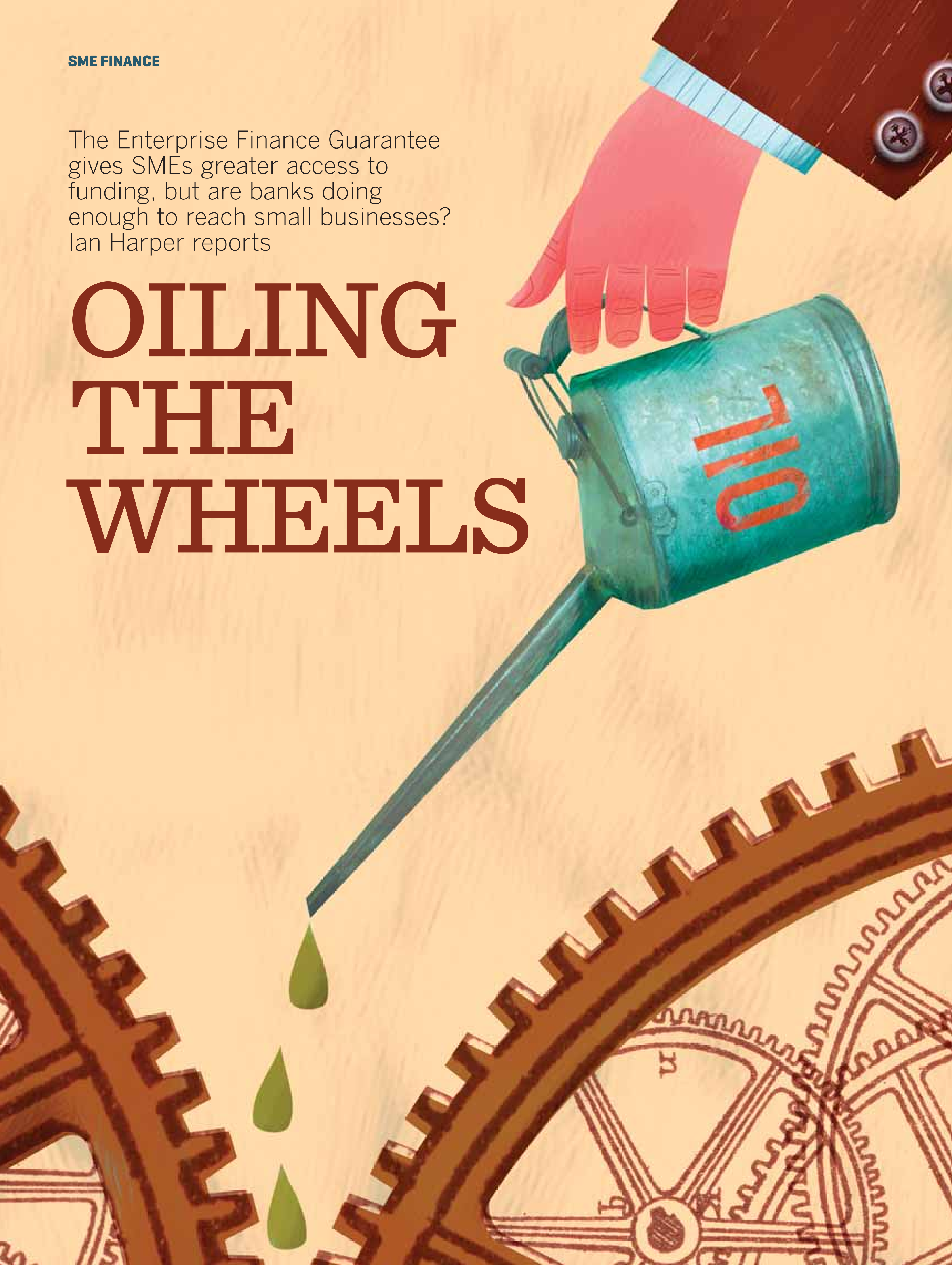
The Enterprise Finance Guarantee gives SMEs greater access to funding, but are banks doing enough to reach small businesses? Ian Harper reports

OILING THE WHEELS



SINCE ITS launch in 2009, the Enterprise Finance Guarantee (EFG) scheme has given almost 27,000 SMEs access to lending worth £2.8bn – lending which, the scheme's administrator, the British Business Bank (BBB), says may never have materialised otherwise.

The EFG facilitates lending to SMEs that are viable but knocked back by lenders because they lack the security to meet a lender's normal criteria. Under the scheme, the Government offers to bear 75 per cent of the risk, to the lender, of default on each eligible individual loan, subject to a cap on the total claims that may be made by each participating bank.

According to the BBB, the EFG is applicable to all businesses, including start-ups: "Across our 40-plus EFG lenders, 18 per cent of EFG programme-related loans offered are to businesses that have an age of 0-3 months old."

Last November, the Government, working with BBB also introduced a referral scheme that aims to put those SMEs knocked back for an EFG loan in touch with alternative sources. Three finance platforms – Funding Xchange, Business Finance Compared and Funding Options – will in turn contact alternative finance providers and introduce an SME to any expressing an interest. Over time more platforms may be added. Details of the scheme can be found at http://british-business-bank.co.uk/bank-referrals

A SUCCESS STORY?

Everyone I spoke to agreed that the EFG had played a valuable and welcome role in making finance available to SMEs – including their own clients – which would have found it difficult, if not impossible, to raise funds elsewhere.

Yet despite its apparent success, there are issues. One relates to awareness of the scheme. According to Murdoch MacLennan, business services partner with Campbell Dallas, while awareness is not an issue within the lending and adviser community, there is only limited knowledge within the SME community.

Rod Mathers CA, corporate finance partner with Henderson Loggie, goes further: "There's a distinct lack of knowledge about the EFG scheme within the adviser and business communities. I know of some experienced advisers who are not clear whether or not the EFG scheme still exists."

Given it's the banks that market the scheme, lend the money and benefit from its guarantee, have they done enough to market it to SMEs?

Catherine Thorogood, senior commercial manager with ABN AMRO's Commercial Finance arm which handles the EFG, stresses the bank has done much to promote its use by suitable SMEs. She points to information on the bank's website and the support given to the BBB in developing adviser materials for awareness raising, including a video for SMEs.

Judith Hartley, managing director, lending solutions with the BBB, says: "Our 40+ accredited lenders typically include information on EFG on their websites and regularly feature EFG case studies in the press. That said, more can always be done. We are working in partnership with our lenders and stakeholders to make sure awareness of EFG is as high as possible."

However, Mark Barry CA, head of corporate advisory at William Duncan, says there is much still to do: "One particular funder has given the merest of lip service to the scheme on their website, and their individual advisers do not appear to consider it a worthwhile option."

According to Mathers: "Some of the more proactive bankers promote the scheme to clients, but sadly the majority seem to ignore it and, rather than being creative, they simply default to the basic lending criteria."

Scott-Moncrieff partner Gareth Magee CA agrees: "Awareness seems to be low simply because the banks don't push the product. In the last quarter of 2015, it was reported that only 446 SMEs participated in the EFG scheme, out of well over five million SMEs in the UK. This is a staggering statistic. Why do banks not push it? There are probably myriad reasons, but the fact they are still getting their own house in order would seem to be a likely reason they don't devote time to promoting a... non-standard scheme that doesn't follow the same rules as the rest of their business products."

According to an ICAS spokesman: "The appetite to use the EFG does vary across the different banks."

Another issue relates to the information given to SMEs. Mathers says there's confusion about who is covered by the guarantee: "In my experience clients sometimes believe that if there is a default the Government will cover their exposure by 75 per cent. However, this »

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Rod Mathers

is not the case, but rather the bank is covered in the event that the principals default on their personal guarantee. Given the scheme is aimed at smaller businesses, often the business owner/manager is less sophisticated when it comes to finance and could easily be unintentionally misled. More can be done to avoid this situation."

Barry points to differences in the minimum lend of various banks: "Based on the individual literature from mainstream lenders, the stated minimum lend under the scheme varies from bank to bank. For example, Barclays state a minimum loan of £1k; HSBC state £10k; and RBS and Lloyds both indicate in the region of £25k. In practical terms, however, it is unlikely you will be able to find any individual within a mainstream lender that will be prepared to work through the process for a lend of less than £50k, and in some cases considerably more than that."

CRITICISMS OR REAL PROBLEMS?

The underlying principle of the EFG is that the Government takes the brunt of the risk of default, which in turn encourages banks to lend to SMEs. On the face of it, it's a great idea.

But according to Mike Smith, director and senior consultant, Jameson Smith & Co, a turnaround and company rescue practitioner, while the EFG is "a great idea" it has its problems, including training, incorrectly set up schemes, and misconceptions about personal guarantees.

On training, he says: "The majority of the problems occur with poor training of bank staff at the outset and the lack of awareness within the SME community. Typically the only way a small business director is made aware of an EFG is via his local development manager. Unfortunately the EFG loan was often mis-sold as insurance 'if the company goes bust' or 'the Government covers 75 per cent of your personal guarantee' if the company fails."

Smith also says some schemes appear to have been set up incorrectly: "I've come across many EFG loans for companies where the EFG loan has been placed in the director's name and not the company's. The director is taking the EFG loan personally to put back into the company as a loan to it. There may be arguments as to why in the normal course of events this may be acceptable – though I cannot think of many – but what happens when things go wrong?"

Then there are the personal guarantees. Smith says: "The biggest misconception is that only 75 per cent of the personal EFG loan will be pursued and, remember, the director will have signed a personal guarantee. Without exception every director I have acted for believed he would only be liable for 25 per cent of the EFG loan. In fact, the bank must vigorously pursue 100 per cent of the personal guarantee. While a big plus of the EFG is that the family home cannot be placed at risk, practically this is often overlooked by the lender unless pointed out. So, assets outside the family are definitely at risk."

ICAS, in its response to the BIS Access to Finance Inquiry, notes: "EFG has been less successful, we believe, partly due to the banks' interpretation of the scheme, which may often require them to take personal guarantees."

Mark Barry says he has been assured, "off the record", that personal guarantees for an EFG loan would in practice only be called in exceptional cases, such as when fraud is suspected. He has not seen evidence to suggest whether or not this policy is being followed.

Hartley says in 2015/16, BBB undertook a "Strategic and Operational Design Review of the Enterprise Guarantee scheme" to ensure it was achieving its strategic objective of improving access to finance for SMEs and was operating as effectively as possible.

All businesses interviewed, she says, reported a significant positive impact from obtaining an EFG-supported loan. "The consensus was that this impact could not have been achieved otherwise," she adds.

Hartley says the review made three key recommendations: "Firstly, that more should be done to increase general awareness of EFG. Secondly, that consideration should be given to broadening the scope of EFG to include other lenders and other types of lending, with asset finance specifically mentioned. Thirdly, that operational transparency and simplicity should be enhanced whenever possible."

In response to the first point, BBB, in collaboration with key stakeholders such as ICAS, is running an EFG awareness-raising campaign targeting SME business advisers.

On the other two recommendations, Hartley says the scope of the EFG has been widened to include asset finance lenders and, in response to feedback from borrowers and lenders on where operational aspects of the scheme could be improved, the BBB has enhanced transparency and simplicity.

IMPROVING ADMINISTRATION

Meanwhile, at the BBB's instigation, RBS has carried out an in-depth internal investigation of its administration of the EFG.

Hartley says: "This flagged up some areas of concern. The BBB insisted that RBS work to understand fully the issues and put them right. As a result, RBS put in place a plan to rectify the issues identified, to ensure that their customers did not suffer detriment and that the taxpayer did not incur any loss. RBS also implemented new arrangements to make sure EFG loans were always given appropriately in the future. RBS has drawn their remediation work to a conclusion. All affected customers have been kept informed throughout the review and have now received outcome letters."

RBS remains an accredited EFG lender. The bank says: "We have made significant changes to ensure EFG loans will always be dealt with appropriately. This includes improvements to systems and controls and enhanced training for our staff."

The EFG is a scheme with great potential, that perhaps needs greater awareness among SMEs and the banks to unlock that potential. The scheme could make an even greater difference, supporting SME growth, but to do so it needs to be embraced more wholeheartedly by the banks – and by the accountancy profession. CA

IAN HARPER IS A FREELANCE BUSINESS JOURNALIST

For more information on the Enterprise Finance Guarantee scheme and the new Bank Referrals to Designated Finance Platforms programme, go online to british-business-bank.co.uk

HOW EFG WORKS

Through the Enterprise Finance Guarantee, the British Business Bank (BBB) provides security to lenders by guaranteeing 75 per cent of any losses that the lender may suffer, if the borrower subsequently defaults. This enables lenders to unlock more finance for smaller businesses.

- The business requiring funding will have a viable proposition and be able to repay the loan, but will typically not have sufficient security or track record to secure a loan.
- The business must be UK-based and with a turnover of no more than £41m.
- The Government, through the BBB, guarantees 75 per cent of the facility to the lender. The business remains liable for 100 per cent of the loan.
- The business pays an annual "guarantee fee" of 2 per cent to help cover the cost of the scheme.

"More can always be done. We are working in partnership with our lenders and stakeholders to make sure awareness of EFG is as high as possible"

Judith Hartley

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THE RIGHT FUNDING OPTIONS

With prospects bright for 2017, make sure you unlock opportunities for growth

BRUCE STEPHEN

Is head of banking and finance with Brodies LLP

BANK OF England governor Mark Carney made it clear, in the Monetary Policy Committee inflation report issued earlier this month, that the prospects for 2017 have improved. The Bank predicts 2 per cent growth in 2017 and 1.6 per cent and 1.7 per cent growth in the next two years. A number of factors are identified, not least firmer momentum in global activity (good news for exporters), higher global equity prices and more supportive credit conditions.

There are many funding options available for business but ensuring the right structure of debt and terms is vital. Along with the growth forecast, highlighted in the Bank of England report, come inflationary pressures and the likelihood of an increased cost of finance. So, given the current availability of finance in the market, now is a good time for businesses to review current finance arrangements, put a clear plan in place and ensure that they have secured the right level and cost of finance. These create a solid platform for businesses to invest and take advantage of the growth prospects.

A number of factors will determine the right type of finance to be provided. For example, term debt and overdraft may be relatively simple to administer, and asset-backed lending can be used to maximise the funding available or to create flexibility around annual seasonal fluctuations.

For some, the availability of finance can be limited where their asset base does not fit squarely with lending criteria. The Enterprise Finance Guarantee (EFG), introduced in 2009 and now operated through the British Business Bank, may assist in these circumstances. If the criteria are met it can unlock much-needed finance for the UK's SMEs.

The lender to the business, if registered with the EFG scheme, will check that the business meets the eligibility criteria specified by the Department for Business. These include that the business operates in the UK in permitted sectors and has a turnover below a certain level. The EFG provides the lender with a 75 per cent guarantee against the outstanding facility balance. An annual fee is payable by the customer to government, in addition to finance costs.

As of October 2016, the EFG had supported £2.8bn of business loans to more than 26,000 UK SMEs.

The Scottish Government has also pledged £500m over a three-year period for private sector business investment. This will be targeted at new and early-stage high-growth businesses, with clear export plans, and will have a particular focus on technology sectors including fintech. Scottish Growth Scheme funding, matched with facilities made available through the recently-announced RBS ESpark fintech hub accelerator, creates tremendous opportunities for the fintech sector in Scotland.

At Brodies, we are working with clients and with organisations such as Scottish Financial Enterprise to identify ways in which these funds can be put to good use in the real economy throughout Scotland – unlocking funding opportunities and providing investment for growth and jobs. CA

For more information about business finance guarantee arrangements, potential ways in which the Scottish Growth Scheme might help your business or what funding options are available to you, contact Bruce on 0131 656 0260 or at bruce.stephen@brodies.com

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