TO BOLDLY GROW...

Businesses operating in the mid-market feel overlooked and forgotten. With investors, policymakers and the media focusing on **start-ups** or **FTSE 100 companies** they have a point. Yet given support they can play a **key role in reviving** the UK economy.

The CBI estimates that companies in this squeezed middle could contribute **an extra £50bn** to the UK economy over the next seven years. While low confidence is hitting **growth** ambitions, funding remains a hot topic for mid-sized businesses. As part of its Squeezed Middle campaign, *economia* in association with **Lloyds Bank** brought together **12 business leaders** and industry experts to discuss funding **options** for mid-sized businesses and consider how growth can be **stimulated**.

Mark Burton, regional managing director at Lloyds Bank Wholesale Banking & Markets, was the host and Richard Cree, editor of *economia,* chaired. Alison Coleman reports

Richard Cree: Middle-market businesses are crucial to the wider economy and the impact they have on the surrounding environment, especially if they are fast-growth companies, is often disproportionate to their size. But one of their main challenges remains access to finance. It is a critical issue for many of these businesses. While it's clear that banks are under pressure to remove risk from their balance sheets, which is the cause of some of the funding issues, there are also demand-side issues.

Mark Burton: Our focus is on supporting SME and mid-market businesses as lending to this segment is core to the success of the bank. The central challenge is a lack of confidence in the wider economy and the impact that has on appetite to invest in growth. We're seeing that the volatility of global economic sentiment is, in some cases, dampening enthusiasm to target growth opportunities that would have been seized upon in benign conditions.

This lack of confidence is impacting on demand for lending. We're working hard to overcome this barrier by bringing down the cost of borrowing and providing a flexible and broad range of funding options.

Piran Mitchell, finance director, Authentic Food Company: We manufacture frozen ready meals and snacks for retail and food service, and are at the lower end of the mid-market sector. The business has grown by 30% over the past two years and will grow a further 12% this year. We have to invest in plant and machinery using debt finance

Round the table: (from far left): John Hayhurst and Mark Burton; (top) Mark Benyon and Alan Firth; (below) Harvey Jacobson; Clive Austin and Michael Brown; Richard Cree

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James Baer, managing director, Amber Taverns

and asset finance, and have no intention of using equity finance.

Harvey Jacobson, executive chairman, Jacobson Group: My business, which is predominantly in footwear, turns over about £70m, split 50:50 between brand supply to major retailers and our own brand. What has become apparent for businesses of our size is that fear of borrowing is not the main issue, it is willingness to lend.

Darren Thomason, finance director, Bowker Group: We're a long-established third-generation family business comprising two transport warehouse businesses with a turnover of £12m to £15m, two BMW dealerships each with a turnover of £50m, and a Harley Davidson franchise. Funding is largely debt finance with retained profits supplemented by term borrowing for property purchases and refurbishments. But we also use asset finance for some purchases. Approaching the bank for term borrowing is definitely more difficult than it used to be.

James Baer, managing director, Amber Taverns: We own 80 freehold wet-led pubs in the north of England, with backing from three venture capital trusts and HBOS. My view is that while the banks have been blamed for being the root of all evil we can't blame them for lending recklessly and then for being too cautious.

Alan Smith, finance director, Firwood Paints and vice chair, Trafford Housing Trust (THT): Firwood is a fairly small third-generation business that has reasonable cash reserves. The only thing that interests us about the banks is the level of service and the charges. THT is a mid-market housing association with a £40m turnover. It has a £145m borrowing facility and our last renegotiation in February was reasonably painful. Next time we need money we'll be exploring the bond market.

Mark Benyon, chief executive, Electrovision: We deal in electronics distribution, manufacturing medical devices, air conditioning and property. All I want to do is pay down debt. But when I'm dealing with the bank I'm not always dealing with the decision maker.

Alan Firth, executive chairman, Meridian Healthcare: We operate in the residential nursing care sector and have 1,473 beds and a turnover of £33m. Next year's growth will come from two new care homes built using our own cash. Having tried to secure funding for the two new builds, the proposal from the bank was to refinance our existing debt, which wiped out any profitability that we could have generated. Using our own cash has worked against us, in that most of our clients are local authorities that see us as cash-rich, assume they must be paying us too much and are cutting fees. We'd like to have grown the business with the bank's support, hopefully by leaving existing debt alone and accepting new terms for new borrowing. But we are focusing on paying down debt and anticipate being debt-free within the next six years.

Clive Austin, director, NVM Private Equity: Typically we would invest in development capital – growth finance for unquoted businesses or buy-out finance for similar sorts of enterprises. We look to fuel their growth, often in collaboration with the bank, though that aspect of the funding landscape is changing.

Michael Brown, senior partner, Berrymans Lace Mawer: We have 150 partners and 1,500 staff and are seeing growth of between 5% and 10% per

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Alison Lever, partner, PwC

annum. There are some interesting new challenges for the legal services sector, with new legislation that will facilitate investment in law firms in a way that has never existed before. That will be of interest to those who finance businesses through private equity and so on.

Graham Bond, partner, Baker Tilly: I deal mainly with entrepreneurial businesses and see a lot of clients based in that squeezed middle, with opportunities for acquisitions and expansion. But all they are doing is paying down debt. There is money out there but it is mainly private equity, not bank lending.

Alison Lever, private business partner, PwC: I'm part of a multidisciplinary team working with medium-sized businesses whose banks are telling them they are open for business. But as we see they are reporting a variety of experiences and a lot of frustrations, often about how long it takes for decisions on lending. There are alternatives to bank finance, but people don't know where to go to find them.

Burton: There are many products that complement traditional debt finance from asset-backed lending through to capital markets. Our approach is to work with management to identify the most appropriate funding for their business and tailor facilities appropriately.

John Hayhurst, director, ECI private equity: We are looking to invest in growth-focused businesses that are headquartered in the UK. We are finding the number of players in the debt markets has diminished, including the number of traditional banks lending. Our challenge is not just bringing in one lead bank but finding three that will lend at the same time. It has become a much more difficult process.

Cree: This raises an interesting dynamic. There is finance around, but it's just not that easy to get. So is supply the issue or is it about access? What needs to change to make the two things match up?

Thomason: We've spent five or six years paying down debt predominantly. We currently have a property purchase going through. We met the bank's credit representative but there is still uncertainty as to whether or not funds will be there. He liked us, and we should be OK, but we are committed to spending the money. We've got the cash reserves to do it but cash is not the way to fund a business long term. In the past you could sit down with your relationship manager and the numbers we are talking about were within his remit to make a decision on. Now it all goes through committee.

Burton: Every bank has a different approach to lending decisions and it's something we continually appraise and tweak to streamline the decision-making process, while upholding credit quality. We have a prudent policy but try to empower those closest to a business to make the ultimate call. We've invested to ensure we have a regionally based credit team that handles 90% of applications. Making this team local and accessible is crucial to understanding businesses' ambitions and ensuring facilities are appropriately structured and priced.

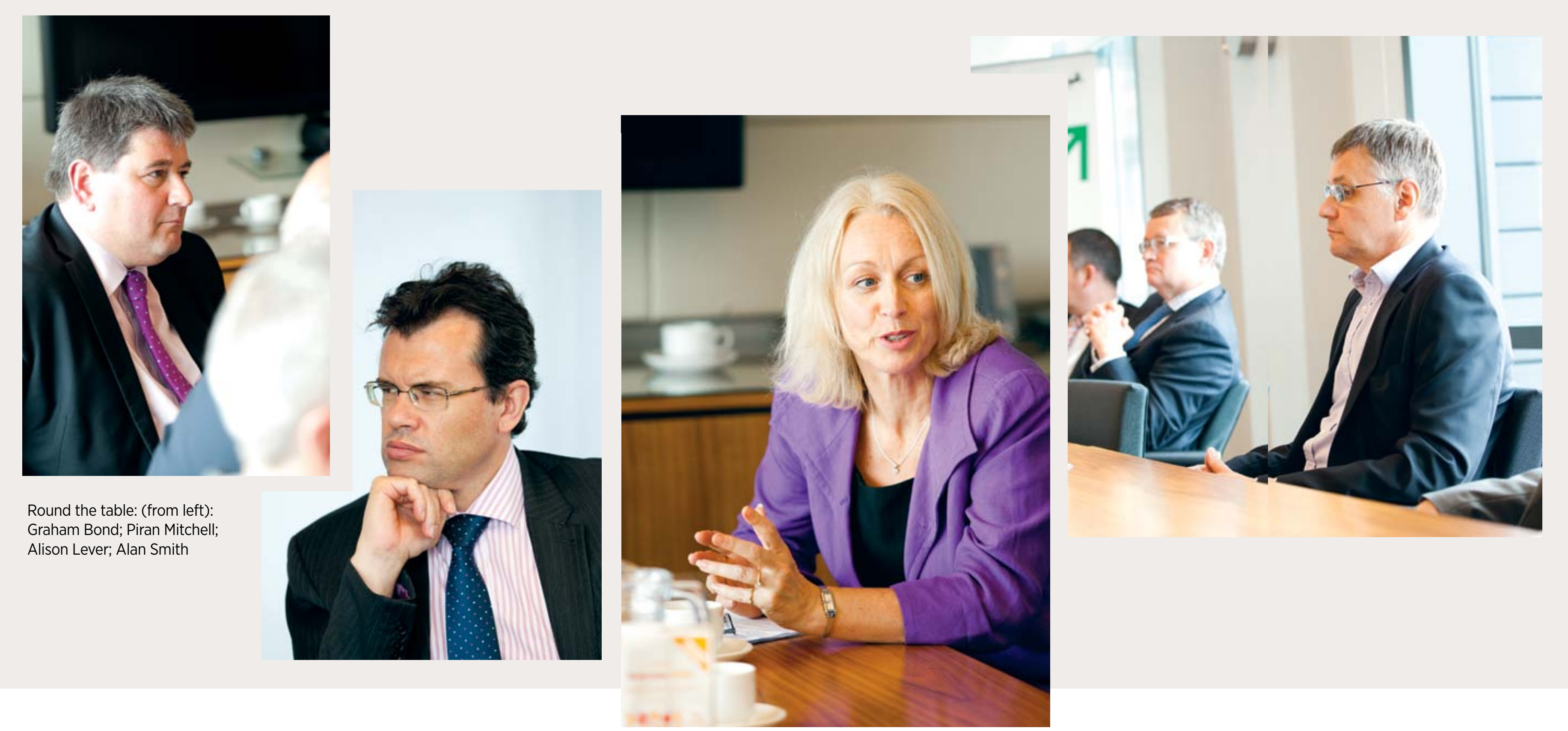
Austin: Is it visibility of the individual, or is it certainty of the outcome? Our view is that it's a combination of the two. We've gone through unprecedented turbulence and it has felt like the credit rule book has been torn up, creating confusion for everyone. Things have improved since the lowest point but even now decisions are being bounced back by credit committees.

Cree: Are business owners providing banks with the right information? Is the quality of leadership and management and financial control an issue?

Austin: I think it is more a lack of clarity about what is driving the key credit decisions.

Burton: It's about remaining true to traditional relationship banking, where the manager, the credit team and the customer understand each other's needs and work closely to a quick and suitable solution. But it comes down to individual interpretation of a situation, getting under the skin of a business and understanding the opportunities and how to mitigate risk. This is continually being speeded up through new processes and technology and will remain central to midmarket banking in the future.

Thomason: There's also a sector issue. Transport and car dealerships are two



Round the table: (from left): Graham Bond; Piran Mitchell; Alison Lever; Alan Smith

THE SQUEEZED MIDDLE PANEL

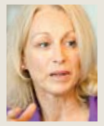

Richard Cree
editor, *economia* (chair)


Clive Austin
director, NVM Private Equity


Mark Benyon
chief executive, Electrovision


Mark Burton
regional managing director, Lloyds Bank Wholesale Banking & Markets (host)


Graham Bond
partner, Baker Tilly


Alison Lever
private business partner, PwC


Alan Firth
executive chairman, Meridian Healthcare


John Hayhurst
director, ECI private equity


Darren Thomason
finance director, Bowker Group


Harvey Jacobson
executive chairman, Jacobson Group


James Baer
managing director, Amber Taverns


Piran Mitchell
finance director, Authentic Food Company


Alan Smith
finance director, Firwood Paints and vice-chair, Trafford Housing Trust


Michael Brown
senior partner, Berrymans Lace Mawer

sectors that the banks want to run away from, even though we are profitable and have been shining lights.

Burton: It's natural that banks look in detail at different sectors, but lending decisions should be weighted towards the individual business and strategy. It shouldn't be a one-size-fits-all approach.

Firth: I agree. We've had 12 years of growth, a solid balance sheet. We are cash generative, we own all our own assets and we have a large sum of equity built into that business. And yet when we speak to the relationship manager, our sector was just described as a basket case.

Jacobson: Sometimes you are tarred with a brush that is different to your own. We had a similar issue a few years ago when a number of footwear retailers went to the wall and suddenly shoes became a dirty word. Yet we are not retailers, we are the supply chain.

Baer: Our sector has also had its share of problems. To be fair to Lloyds, when we submitted our credit application a credit specialist came out to do the due diligence, pulled the business model apart and put it back together. It was a necessary part of the process given the general climate and the sector, and it costs time and money. It's also frustrating but, if you've had your views and practices challenged and ticked all those boxes, it's not a bad process for a business or the banks to go through.

Cree: Is there enough awareness of the various alternatives to bank finance, such as those highlighted in Tim Breedon's recent report to government?

Jacobson: If we look at private equity, I see a big fear factor and a perception that they will hammer you harder than the banks.

Hayhurst: Businesses don't understand private equity and the reality is that our finance won't be suitable for all business opportunities. How we operate is to seek leverage and work as partners with the management team. There shouldn't be a fear factor. However, I accept that as an industry there is a PR job to be done to get that message across.

Burton: Looking at asset finance, options such as invoice financing can be a good way to fund growth and it's become more of a mainstream form of finance over the past decade. It's clear that businesses now appreciate the additional flexibility it gives them, particularly during times of peak activity where a swift cashflow boost enables them to fully capitalise on an opportunity. If you look at how £100m plus turnover businesses in the US now fund themselves, that investment is coming from the bond and pensions market. Look at some of the PLCs in the north of England and you'll see some of that money is now filtering into those businesses. It will be interesting to see how that develops over the next few years, and whether it starts to filter outside the FTSE 250 PLCs.

Austin: For a long time in the private equity industry there was a reluctance to use asset finance. You'd have spells where it worked well, but the minute you needed the money to rely on, it disappeared, because your debtors shrank, so a lot of private equity was used for structures that avoided asset finance.

Benyon: The asset that you have is that someone owes you money. Is that worth anything when people are going bust and the property market starts coming down like a pack of cards? What is that debt worth? Nothing – because they can't pay.

Jacobson: If you have a balanced sales ledger on invoice discount banks will normally advance 80%, so clearly the banks are looking at the detail behind the sales ledger.

Burton: Banks can get access to sales ledgers on a quarterly rolling basis, so they get to know the age and profile of the ledger. Where you have asset-backed lending, if you put in place a facility that is more capital efficient for the bank, they pass some saving on to the client. It's complementary to traditional funding.

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> **John Hayhurst,** director, ECI

Cree: In terms of professional advisers, are alternative sources of funding an area people are asking you about?

Lever: There are quite a few cash-rich businesses that don't want to go to the banks. Yes we do get people asking us where they can go for funding, as well as how to find it. The regional growth funds are there but are quite tricky to get at.

Bond: They are concentrating on reducing bank debt. There are opportunities to make acquisitions but it is about the refinancing. A few years ago you were seeing IPOs every other month, but there are a variety of different models and options.

Cree: Turning to the subject of innovation, some say it's what got the banks into a mess in the first place. But it seems that there is a need for some innovative financial thinking.

Jacobson: We've just identified one idea – taking the bond market and pension market to medium-sized businesses instead of large businesses. Innovation is there but you need to know where to look for it. If you're with one of the more credible business services practices they can point you in the right direction. It will cost you, but you'll get the advice that you're looking for.

Cree: So what's stopping businesses? Is it fear of risk? Is it the wrong time for innovation at the moment?

Smith: What is the motivation for producing a new financial product? It's the return on investment on the previous one. And given that many businesses perceive financial products as too expensive anyway, why would you go ahead with it if it costs more and it doesn't make a return?

Burton: Our focus is to raise awareness of new initiatives that bring down the cost of borrowing for everyone. For example, the National Loan Guarantee Scheme (NLGS) and the forthcoming credit easing scheme [subsequently announced as the Funding for Lending scheme] should help encourage businesses that now is the time to invest for growth. We're seeing good demand for the NLGS and expect the new scheme to be very popular due to the impact on the cost of funding and its flexibility.

Hayhurst: The response to our business growth survey has been quite optimistic. But the challenges include the difficulties in sourcing finance, the fact that regulations are always changing and tax rates that are too high. It comes back to a confidence issue.

Burton: Have the banks gone too far with de-risking and being too conservative? What are they doing to get things moving? There is a sense that this fear factor and the drive to be rid of debt are messages that are not being played back. How do we get that confidence back?

Thomason: There is also a lot of uncertainty in the economy, in particular over what's happening in the eurozone. What would the banks' reaction be if Greece or one or two other countries have to leave the single currency?

Burton: There are several different views, but this is something we've anticipated for a long time. Like other banks we have contingency plans in place for a variety of scenarios, down to the minutiae of individual clients overseas who need currency. What all businesses can expect is that the banks are planning and we will be very well prepared for every eventuality.

PAUDIE SPILLANE