Piecing together the **financial resources** that you will need for your business

Over the next 12 pages of this edition, we look at the practical aspects of funding businesses, making them grow and then releasing capital value when the time comes. As established entrepreneurs and managers, you will have reached different stages in the process. Select the features which meet your requirements.

When a local authority was persuaded to run a part-time course on managing small businesses, its prospectus opened with the words . . .

> "Conditions have never been more difficult for the smaller business. The difference between survival and going out of business is an ever decreasing one. While large organisations can employ sophisticated management techniques, a small enterprise depends totally on a few key personnel. This course is designed to help the management of small and expanding firms apply modern techniques to their own businesses."

It is probably not worth readers phoning *The Informed Executive* for details of how they can book their place on the course, as it started in September 1974.

There is a sense of déjà vu about that introduction, as no-one at the time could remember conditions for businesses across the spectrum being so difficult. The UK economy was in the grip of a recession; there had been a three day week a few months earlier, and the FTSE All Share Index was hovering around the 130 mark (compared with 1750-1900 in the Summer of 2011, although the bases for comparison were not quite the same). Feelings had been running high a few months earlier about the rising cost of petrol, which had reached a staggering 50 pence a gallon – about 11 pence a litre.

The Government had at least come round by that time to the idea that small businesses were a recognisable species of commercial animal; not simply a low-turnover version of a much larger entity, as had been the view in Whitehall for generations. In establishing the Small Firms Information Centre within the Department of Trade, Whitehall had taken the first of many initiatives over the next three decades and more, to assist the small and medium enterprise.

'Assist' is perhaps a better word than 'support' which has about it an air of impending failure and bail-out rescues, as in 'support for the car industry'. There has to be a clear distinction drawn between the re-financing of the banking sector three years ago – which was 'support' in its most literal sense – and the programmes of assistance for entrepreneurs to help marshal and manage their assets more effectively.

SME organisations play a major role in the economy

Expressions like 'small firm' and 'SME' somehow underplay the significance of this sector within the economy as a whole. The total demand for funding created by the 'small and medium enterprise' sector is huge. SMEs account for more than half of all employment and 50% of the nation's GDP.

The Department for Business Innovation and Skills (BIS) would be the first to recognise that the SME community does not comprise just corner shops and exhaust repair centres: the accepted definition of SME can take in businesses with close on 250 staff and accounts for around 4.7 million operations.

The definition of 'SME' is now so broad that there are in effect many tiers within that range, from sole trader consultancies employing no staff at all, for

Economic conditions can drive a business into deep water

Successive governments have developed solutions intended to help the SME keep on firmer ground

example, to sizeable enterprises operating as a group of trading companies and touching the upper limit of SME status. BIS itself splits small businesses into sub categories depending on the number of employees involved - micro (0-9 employees), small (10-49), and medium (50-249).

A single 'smaller' business can find itself in different parts of the SME spectrum depending on the nature of its 'relationship' with the financial sector or the regulatory authorities. A business which is below the barrier in one area - whether it now has to file accounts at Companies House, for example - but is treated as a 'larger' SME for other purposes.

It could be argued that what confuses most businesses below the recognisably 'corporate' entity is the uncertainty over what band they fit into when they come to apply for funding or other forms of assistance. This lack of clarity makes it more difficult to target the most appropriate facilities for taking the business forward.

Problems in finding finance

It is clear from our conversations with readers of *The Informed Executive* that securing finance is probably the most pressing matter that business owners have to address today. Even if operating in sectors where there is no apparent fall in demand, the chances are that there will be difficulty in maintaining the flow of funds to make this happen.

But financing the smaller business has always been a problem. The course which was highlighted at the start of this item included multiple sessions on the subject, including one on 'the financial limitations on the smaller organisation.

The Small Firms Loan Guarantee Scheme which appeared in the mid '80s had faults in its concept but generally helped a large number of businesses raise the kind of finance needed.

The banks took minimal risk as even the 25% being covered by the borrower were effectively covered by personal guarantees.

Banks became adverse to risk

A generation later, the Labour Government introduced The Enterprise Finance Guarantee Scheme in the wake of the banking crisis which had had the effect of closing off credit for all but the bluest of blue chip companies.

It is accepted that the situation had arisen at least in part through banks taking too much risk, including involvement in sub prime markets.

By the Autumn of 2008, the pendulum had swung in the opposite direction, and the banks became risk averse. The problem was compounded by the fact that the same institutions had a shortage of capital.

An important element of the Government's banking strategy at the time, the Scheme was open to businesses with an annual turnover of up to £25m seeking loans from £1,000 to £1 million. It appeared to be a comprehensive initiative.

But the fact that the banks had first had to satisfy themselves that a business and its proposition were both valid meant that they were inclined to lend to companies with an established track record and which they would not wish to lose to a competitor.

The banking community quite reasonably took the view that a less rigorous lending policy would only jeopardise their operations further, demonstrating that the Guarantee Scheme a the time was an example of political style over substance.

In February 2011, the present Government agreed with the major UK banks that they will provide £76 billion of gross bank lending to SMEs in 2011, an increase of 15% on 2010.

It has also committed to extend the Enterprise Finance Guarantee Scheme (EFG) for the remainder of this Parliament, supporting up to £2 billion of lending to businesses.§

Securing finance is probably the most pressing matter that business owners have to address today. The entrepreneurial spirit can be dampened by the constant need to source funds in the early years.