Northern Ireland Assembly

Committee for Enterprise, Trade and Investment

OFFICIAL REPORT (Hansard)

Access to Finance Report: Economic Advisory Group Briefing

16 May 2013

NORTHERN IRELAND ASSEMBLY

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Members present for all or part of the proceedings:
Mr Phil Flanagan (Deputy Chairperson)
Mr Steven Agnew
Mr Gordon Dunne
Mr Stephen Moutray
Mrs Sandra Overend

Witnesses:

Ms Kate Barker	Economic Advisory Group
Ms Patricia O'Hagan MBE	Economic Advisory Group

The Deputy Chairperson: The Committee will be briefed today by Kate Barker, the chair of the economic advisory group (EAG), and Patricia O'Hagan, who is a member of the group. Ladies, you are very welcome. You should make a short introductory statement, and we will follow that with some questions.

Ms Kate Barker (Economic Advisory Group): Thank you very much for giving us this opportunity. I will start by saying a little about why we started the work, although that may be obvious. We are in a very long period of trying to recover from the big recession, and the work on the EAG makes me conscious of the fact that Northern Ireland has a particular set of problems that is not necessarily quite the same as that in the rest of the UK. However, it is clear that, in the whole of the UK, access to credit for small businesses in particular has been a major topic. Although it is important to put that into perspective, I am sometimes slightly anxious when people talk as though we just have to solve small and medium-sized enterprise (SME) finance and the world will be a different place. Although it is an important issue, that is not correct. The Minister of Enterprise, Trade and Investment and other stakeholders are clearly concerned about the issue, and, in the report, we wanted to work out a better idea of the picture on access to finance to establish what support is around, the level of uptake and why there are deficiencies in the market. However, we did not start out with a particular prejudice that there was a problem for SMEs accessing finance, and we wanted to be sure that there was a problem before we moved on to solutions.

Considerable research was undertaken on our behalf. There was a detailed survey of 1,000 businesses across Northern Ireland and consultations with all the main banks in Northern Ireland, the British Bankers' Association, the Bank of England, the National Asset Management Agency, the Banking Appeals Task Force, the Irish Credit Review Office and, as you would expect, business stakeholders and people across the relevant economy Departments.

Here, as in the rest of the UK, there is a big contrast between viewpoints. Local businesses and the local business community will comment on the unwillingness of banks to lend and the fact that they find rates very high or that they often find conditions for lending more onerous than they used to be. On the other hand, the banks tell us that they are open for business and willing to lend to viable trade and businesses, and they refer to the low level of demand. If I was to sum up the message from our report, it is that both of those have some truth but that the picture is quite complicated. At the moment, if anything, the evidence is perhaps stronger that the demand for finance is low rather than the supply side being weak, but it is important to make the point that, as the economy starts to pick up — in the UK, we are starting to see the economy pick up gradually — it is important that banks are in a position to support a recovery. The concern is that the situation that has prevailed for the past few years has left banks and businesses in the kind of state where it seems likely that, when economic recovery starts, access to finance will be more of a problem.

The research suggested that demand for bank loans in 2012 was relatively low, and only about 8% of the SMEs surveyed applied. That is very similar to surveys in the rest of the UK and in the Republic. Of those who applied, the success rate was about 66%, and there was also evidence not only of unsuccessful applicants but of people who were discouraged from applying. The report refers to that. The report also refers to issues with increases in fees and charges for arrangements. It is important to say that although the proportion of firms that have had difficulty accessing finance is low, they still represent a significant number of businesses, and it may get worse when things pick up. On the supply side, it is clear that bank lending has been falling in the UK over the past five years. As you know, it is difficult to get hold of the evidence in Northern Ireland in particular, and there is a significant data gap. We express concern about that in the report. Shouting at the banks is not much use because we all know that the banks are working to strengthen their balance sheet to deal with the overhang of bad debt that they accumulated and to deal with the fact that they need to hold more capital against their loans generally. It is not surprising in this environment that borrowing costs have risen. It is clear that the margin for banks everywhere between the rates that they get their money in at and the rates that they lend it out at have increased since before the crisis. One of the issues is about how much SMEs recognise it.

Particular issues in Northern Ireland include the fact that the national policy responses, the funding for lending scheme, and so on, have not had as much traction for a variety of reasons. That is particularly important, given that one of the points that we make in the report is that there are more SMEs here as a proportion of the business community than in the rest of the UK. There are some potential market failures here. There is a market failure in SME understanding of loans and whether they should use bank loans or other sources of finance. There is market correction on behalf of the banks, and they are in a position in which they are probably lending less than is needed to sustain the economy. The property debt overhang is causing problems. In general, there is quite a lot of evidence that there are difficulties.

The report has 13 substantive recommendations. They are not all to be implemented by the banks. Some are for business organisations and government. The recommendations, if carried out, will make a difference to the ability of businesses to access finance. I really stress the importance of getting some changes now, so that, as the economy picks up, businesses are able to access finance. That will be the point. As we all know, it is often when economies recover that businesses really need a bit more funding to finance the capital that they need to draw in and to grow. It is vital that steps be taken now, otherwise the growth opportunities may be missed in two or three years' time.

Thank you for letting me make that statement.

The Deputy Chairperson: Thanks for that. Have you assessed the demand, not for traditional bank lending but for equity finance or venture capital here?

Ms Barker: We did not do such a thorough assessment of that, although we asked businesses whether they had looked at it. Patricia might like to talk about that; I should have offered her the opportunity to make some opening remarks. One issue that you find here and elsewhere is that companies are sometimes reluctant to move into equity finance because they prefer bank finance. There is certainly evidence that, historically in Northern Ireland, companies have preferred to use bank finance. Perhaps you would like to say something about equity finance, Patricia.

Ms Patricia O'Hagan (Economic Advisory Group): Thanks, Kate. I am an owner/manager of a local software company in the high-tech sector. It is always a struggle for us to access the finance to run and grow our business. The situation has worsened in recent years. To us, the options are limited. Bank finance is not really an option for us because we do not think that the banks really understand how our business operates or what our business model is. We have been unsuccessful in using loan funding as a source of finance. Equity is certainly an attractive option to us, if it is available. We have sought equity funding in the past, but it did not come to pass for us. We had options but decided not to take them. As a technology company, we see that as a viable option, probably because of the perceived risk around our business and the relative amount that we need to borrow to finance our business.

In Northern Ireland, our options were limited. We had to look outside Northern Ireland to try to access non-loan funding. Things have improved of late with the Invest NI initiative for access to finance. There are more options available to technology companies now than there were three or five years ago. We welcome that very much. As we encourage more of our young people to go into science, technology, engineering and maths (STEM) subjects, and as we see the activity coming through the science park, there is a gap between the amount of funding available to those start-up high-tech companies and what is needed to grow them through the whole life cycle from product conception to reaching the marketplace.

The Deputy Chairperson: Have all the recommendations been accepted by the relevant people?

Ms Barker: I am not really able to say whether they have all been accepted. I know that there have been ministerial meetings and discussions about them. There have also been discussions with the business organisations, and discussions are going ahead this week and into next month, I believe, with the major banks to talk about how they feel about the recommendations. The EAG will meet again in August, and I would be very disappointed if by then we do not have a clear picture of how the recommendations are being taken forward. I would be particularly disappointed if the implementation panel were not to have been appointed, because, in some sense, the reason why we suggested an implementation panel was because we wanted somebody to be charged with driving it forward and bringing to it the energy that it needs. It is important that that panel be put in place relatively quickly.

The Deputy Chairperson: Is it the Department that you want to appoint people to that panel?

Ms Barker: Who do I want to be appointed or —

The Deputy Chairperson: No; who will do the appointing?

Ms Barker: I expect the Department to do the appointing. I am relaxed about that. It is important that it is somebody who has a good understanding of business finance. I would also hope — given that we have spoken about a "panel" — that they are not necessarily all from Northern Ireland. It is often useful to bring in people from outside; I am not saying that people from outside have all the answers, because they do not. However, it is often useful to bring in people with different backgrounds and experiences.

Mr Agnew: Thank you for the presentation and for the work that has been done. I want to make sure that I understood what you said, Patricia. You mentioned that start-up money is there for your type of business, but the problem is the next stage: you can get started, get off the ground, but you are then stuck. Is the idea that you can keep a small business ticking over but you cannot grow it? Is that the picture as you see it?

Ms O'Hagan: Yes. There has been an improvement at the start-up level, and more funds are available. However, you need a relatively small amount of money at that level. To take an idea through to the market, you have to go through different stages of proof of concept, market testing and commercialisation. As you go through those stages, you need larger and larger amounts of money. Certainly, at present, there is a gap. Even at the access to finance continuum, there is a gap at the commercialisation end when companies may be looking for deals of between £500,000 and £2 million. Nothing is available in Northern Ireland at present for companies with that need.

Mr Agnew: You said that you do not feel that the banks understand your business model. There are always two sides to that. Do the banks not understand, or are you not presenting it in a way that they can understand? I do not mean to be critical in saying that. I am just thinking what the banks might say were they here. From your point of view, is that because yours is a relatively new and emerging industry in Northern Ireland? We have heard from Momentum about the potential that it sees in this sector. Is it that the banks do not have people with the expertise to understand it because it is only a growing industry and none of these people comes from within the industry? If that is the case and I understand you correctly, how do we solve the problem?

Ms O'Hagan: I take your point. I think that we are able to communicate the value and strengths of our business because we can do that effectively in a venture capital environment. People in the equity funding space probably understand our type of business better; they would recognise the values and ask us about our depth of knowledge in the market, what is unique about our offering and how we have protected it so that others cannot steal our ideas. We do not have those conversations with the banks. Fundamentally, it is an engineering business. Our engineers are software developers; their tools are a laptop and a broadband connection. Go into our office and you will see a few people sitting around, a few geeks tapping on a computer.

Mr Agnew: In that sense, you have enough capital.

Ms O'Hagan: Yes, and we do not need an office. We can even operate from home. We do not have racks of stock. Our software is stored in Docklands in London, so it looks so different to someone who is used to assessing, perhaps, an engineering business that has physical product. Even our balance sheets probably look different. We have a bank in the US, and it sees the value in our intellectual property and our patents, whereas that value is not recognised locally.

Mr Agnew: To me, that seems like a fixable problem. If there is an opportunity for the banks, they will not want to miss out. They will not let the whole industry pass them by. I am, possibly naively, positive that, through conversations, perhaps instigated by the new implementation group, they will see what upskilling is needed.

With regard to equity and venture capital finance, I was at a presentation about the Halo business angel network. Halo was at pains to say that it is not 'Dragons' Den', but it is a similar sort of idea. What is the problem there? Are the sums of money too small? You mentioned having to go outside Northern Ireland. Is it that the sums of money that those people are looking to invest are too small, or are they still conservative and reticent about investing in this industry? It is new to me, so I am interested in the feedback.

Ms O'Hagan: The angel investor is a very good model. Success can be seen in regions such as Scotland. It is early days for us in Northern Ireland, and Halo — our angel network here — has started to grow over the past couple of years. It won an award for being a very good network. It is early days, and if we can get more of our local high-net-worth people involved in it and get them down to the science park to see the opportunities, I am sure that it will grow. However, it is still in the relatively early stages.

(The Acting Chairperson [Mr Moutray] in the Chair)

Mrs Overend: Much of what I was thinking has already been discussed. I have one question. Do you give any credit to the thought that companies or businesses should be more inclined to look towards angel investors as opposed to banks for money to grow their businesses? Patricia, you spoke about that from your perspective. Kate, I would like to hear your views.

Ms Barker: It is striking that businesses rely more heavily on bank finance here. Given the size of the economy, perhaps it is not surprising. Patricia spoke about business angels being a little slow to develop. Of course, you have to have the right number of angels in the first place. People understand that many businesses are reluctant to give away equity but, if you really want to grow a business, that is often what you will have to do sooner or later. It is always difficult to judge whether it is a supply or demand problem. If there is less experience of using equity, it is not surprising that people are more reluctant to do it, so you have to build towards it. I am quite encouraged by some of the initiatives that are moving in that direction, but, as I keep harping on about, when the economy really needs to grow, there is a question about scale and whether the scale is sufficient. I hope that the implementation of the report's recommendations will build towards a better scale of that kind of approach and a better knowledge of how it works.

Mrs Overend: Do you feel that your recommendations apply equally to microbusinesses in Northern Ireland as well as larger businesses?

Ms Barker: From a more economic point of view, the major concern is not so much microbusinesses — I do not mean to say that they are insignificant — but growing businesses. It is the kind of business problem that Patricia described. For the future, you want some of those businesses to come through, contribute to the economy and take on employment. I am sure that microbusinesses have experienced more difficulty recently in getting capital because people's housing collateral has fallen so much. That is also a problem in the rest of the UK. By and large, the real focus of our concern is probably a little further up.

Mr Dunne: Thanks very much for coming in today. Patricia, is the problem that the banks do not understand your business or how your processes work? We are aware of the fact that banks are not able to assist businesses such as yours, so what is the real problem? A number of organisations such as yours carry out that type of business. What are the real difficulties with the banks?

Ms O'Hagan: It is probably sectoral skills and, for the banks, whether their staff have that range of experience. Most of the banks are organisations that are based outside Northern Ireland, so, within the group, I am sure that they do have those skills. Perhaps that could be fed back to the local branches.

Mr Dunne: One of your recommendations is that staff should be trained and developed in changing skills and demands.

Ms Barker: Yes. I think that that is right. It is not uncommon for people to think that banks do not always understand new business models and the speed at which businesses are changing. There have been rapid changes recently. Even in what we think of as traditional businesses, new ways of doing business emerge that banks do not always recognise. The word "training" sounds patronising. It is more about ensuring that people get out into the business community to understand how it is changing and how they can respond to it.

Since the recession, many banks have looked at sectors and said that they will not lend to them at all. That is too much of a blanket ban because, even in a sector that is performing relatively badly, there can be companies with much better prospects. It is about understanding sectors better and having a better ability within that sector to judge who has a good business plan and who will be able to survive a difficult period. I am thinking in particular of the construction sector. It is not the case that every construction company is going to disappear.

Mr Dunne: No, but it comes down to risk. With funding, are banks assessing risk properly?

Ms Barker: If you examine what has happened in the financial crisis on a bank-wide basis, it is clear that SME lending is the area in the UK in which banks have lost most of their money. That means that banks are looking at that and thinking that, in the run-up to the crisis, they made real mistakes, and their lending was too risky. Now, because the banks are short of capital, they have moved to the other side and become very risk averse. I am sure that Patricia will say that it has gone on for longer than the crisis, but it reinforces the banks' tendency to lend to businesses that they know and can easily understand. When the banks are not lending very much on the whole, they want lending to be risk averse because they are trying to rebuild their balance sheets.

The current situation could be described as a market failure. The banks are being too risk averse, partly because of the nature of their own balance sheets. It is not easy to change that situation, unless government says that the banks will have to do more risky lending. That does not sound like a great message against the background we have just had. It is not about telling the banks that it is more risky but saying that, if they were better at understanding sectors and companies, they could do better lending, which, in the long run, would yield better results. There is a sense that some skills have decayed a little in the banks. They lend on credit-scoring models, but perhaps they need to move away from that to more understanding assessments. That is the issue we are driving at.

Mr Dunne: Are SMEs aware of the work and initiatives of Invest NI and InterTradeIreland and the assistance that is available from those agencies?

Ms Barker: The evidence in the report is that many SMEs, particularly microbusinesses, unsurprisingly, but, more surprisingly, some medium-sized businesses, are not as aware as they should be of the range of initiatives. They are particularly unaware of some of the UK-based initiatives. It is difficult to get UK-based initiatives to work well here — actually, they do not work that well in the rest of the UK — partly because the population of banks is different. The need for better information flows is not the most exciting recommendation, but it is important to try to think about better ways to get through to businesses what it is that they can apply for and expect to find.

Mr Dunne: Do you think that there is still a lot of work to be done on that?

Ms Barker: Yes, I do.

The Acting Chairperson: Recommendation 2 states:

> *"banks [should] review the level of training provided to staff dealing with applications for business finance."*

In effect, are you not saying that banks do not understand their customers? Is it not in the banks' best interests to understand their customers and their requirements?

Ms Barker: Yes, it is. I will come back to the point that I made that, at present, banks are lending in a rather risk averse way. So, it is a question of trying to tell the banks that you can have what is thought of as collective action failure, as I have heard it described, whereas if all banks lent in a slightly more risky — perhaps that is not the right word — aggressive or positive way, you might get a better result for the economy as a whole. Each bank individually may be reluctant to do that, partly because of their own difficulties with capital and partly because of the fact that if one bank is the only bank doing that, there may be adverse selections — people who come to that bank readily who are quite risky. One reason for setting up an implementation panel and having more discussions between the banks as a group and their customers is to try to raise the level of understanding across the board and change behaviour collectively. It can be the case that what makes sense for one organisation and what makes sense for all organisations is not the same thing.

The Acting Chairperson: Thank you very much for presenting to the Committee today.