

The British Chambers of Commerce believes that the fragility of the banking sector poses an ongoing threat to economic recovery. The Government must remain alert to the continuing difficulties that small and medium-sized businesses face accessing credit.

Summary

The near collapse of the financial system in September 2008 resulted in a huge shock to the credit lines utilised by the business community. This subsequently created cashflow difficulties and payment problems within supply chains.

The Government intervened to recapitalise banks in difficulty, and also introduced a number of schemes in an attempt to address the problems created by the credit crunch. While these interventions have experienced some success, it is clear that access to finance remains a concern for many businesses, in particular SMEs.

In light of this, the BCC believes that the Enterprise Finance Guarantee scheme should be extended beyond March 2010, and that the Bank of England should consider targeting access to finance more forcefully through the monetary policy options available to it.

Problem

Following the collapse of Lehman Brothers in September 2008, structural weaknesses were exposed in the entire financial system. To prevent the disastrous collapse of large financial institutions, Governments across the globe were forced to intervene on an unprecedented scale.

The fall-out from the crisis was huge disruption to bank lending practices. Chamber of Commerce members reported the following experiences:

- Sharp increases in arrangement fees and interest rates relating to credit lines;
- Renegotiation of lending agreements halfway through term; and,
- The indiscriminate and arbitrary withdrawal of credit facilities.

The worst incidence of this was certainly felt at the end of 2008 and the start of 2009, with the situation now having improved relative to the chaos of this period. However, it is evident that a problem still does exist. While it is true to say that demand for finance is weak, there are still fundamental problems within the system.

This fragility is a major threat to economic recovery, which is forecast to be slow and protracted, and question marks remain over how well banks will respond to an increase in demand for finance when any recovery gathers pace. Ultimately, this indicates that the problem is not simply a short-term one.

However, the business community must accept that it no longer operates in the lending climate that preceded the financial crisis. Attitudes to risk have fundamentally altered, and an understanding of this is necessary to engender positive relationships between financial institutions and their business customers.



Evidence

A BCC poll of 400 businesses in November 2009 reported that 33% of companies found accessing finance more difficult over the last three months (3% said it was easier, with 64% stating that it remained the same). This compares with the same question asked in June 2009, when 20% of businesses believed access to finance had worsened (6% saw improvement, and 74% stated it had remained the same)¹.

A range of Bank of England (BoE) output supports the BCC's view that significant problems still exist within the lending market, particularly for SMEs:

- Contacts of the BoE's Agents continue to report concerns over access to finance. Larger firms did report an easing in conditions, but generally they remained tighter than in mid-2008².
- According to the BoE's Trends In Lending Report, the flow of net lending to UK businesses remained negative in September 2009, and lending to companies fell across all the main sectors of the economy in Q3 2009³.

Recent Government Policies

The Government still holds huge stakes in RBS and Lloyds, which benefited the most from recapitalisation. Ministers do have the capacity to influence these institutions, but have remained staunch in their insistence that the part-nationalised banks will ultimately operate at arm's length from Government.

However, the Government has launched a range of measures designed to help businesses in need of credit. More direct policy relating to the real economy include:

- The Enterprise Finance Guarantee, a guarantee facility for small businesses, intended primarily to improve the availability of working capital through term loans and the consolidation of overdrafts. So far, over £600 million of loans have been offered from the £1.3bn made available up until March 2010.

- The £75 million Capital for Enterprise Fund provides equity and quasi-equity of £250,000 to £2 million for viable companies with a turnover of up to €50 million in need of long term capital.

In addition, the banks in which the Government holds a stake have committed to certain levels of lending within an agreed period. As a gesture of goodwill, other large banks, such as Barclays and HSBC, have followed suit and outlined commitments.

It is also worth noting the Bank of England's quantitative easing programme. The Governor of the Bank has to obtain permission from the Chancellor on the level of asset purchases that can be made under the scheme. A consequence of QE is that banks will find themselves holding more reserves that can then be used to lend to businesses and households, although this has yet to turn into tangible evidence of improved access to finance.

Inevitably, this form of stimulus will have to be wound down. Indeed, the Bank of England has already begun to slow the pace at which money is injected into the economy, and this potentially has implications for lending capacity.

Opposition Positions

George Osborne, the Conservative Shadow Chancellor, has proposed a £50bn National Loan Guarantee Scheme, arguing that it would be more comprehensive than the Government's EFG. He has also called on the Treasury and FSA to stop retail banks paying out profits in cash bonuses, instead using the cash to support new lending.

Liberal Democrat leader Nick Clegg, has stated that, as taxpayers own a stake in some banks, Government representatives in those institutions should be insisting on lending strategies and not just suggesting them. The Liberal Democrats have also made the case for investment banking to be separated from retail banking so that businesses dependent on high street banks are not put at risk in the future.

¹ BCC Monthly Business Survey, November 2009

² BoE's Agents' Summary of Business Conditions, November 2009

³ BoE, Trends in Lending, November 2009



BCC Policy Position

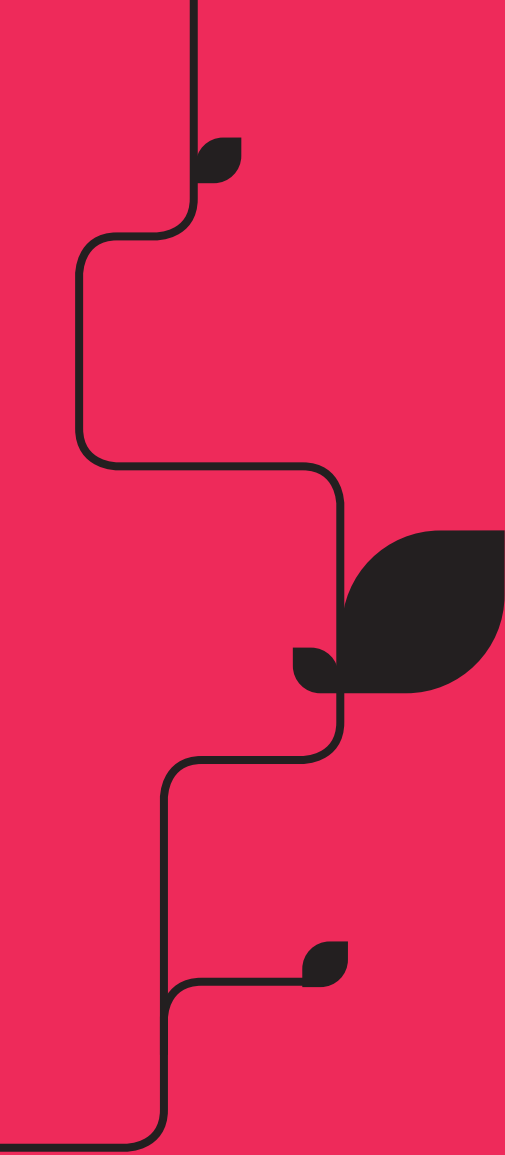
The BCC believes that persistent weakness in lending poses very real threats to a sustained UK economic recovery.

The Enterprise Finance Guarantee scheme, which has been successful helping firms operating at the margins of bank lending during the downturn, should be extended beyond March 2010. Enough cover should be made available to ensure the scheme can meet demand from all eligible applicants. It should be extended for a time-limited period and its viability re-evaluated at regular intervals.

The Bank of England has adopted unconventional monetary policy techniques through the implementation of quantitative easing. However, it would seem that the main limitation of the QE programme so far has been its inability to boost bank lending, and, therefore, the Monetary Policy Committee must place greater emphasis on this problem. Cutting the interest on reserves held by banks should be reconsidered at forthcoming meetings, to incentivise greater lending.

The BCC continues to sit on the Small Business Finance Forum, which was created to open a dialogue between the business community and banks. We are also working to convene a panel specific to the problems of mid-sized businesses, where access to finance difficulties appear to be particularly acute.





APPLICABILITY

UK wide.

CONTACTS

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