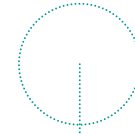


**Press Cutting:**

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# Director

- > Entrepreneurs
- > Leadership
- > Finance
- > HR
- > Regulation
- > Advice & training
- > Management
- > Marketing
- > Technology
- > Sustainability
- > Corporate governance
- > Business Travel
- > International
- > Book reviews



- Latest issue
- Previous issues
- Supplements
- Director guides

by Jane Smart

## CREDIT CRISIS

### Rescue package starts to repair damage

by Peter Bartram

*But is it enough to encourage all the banks to lend again?*

Will the banking "rescue package" announced this morning by Gordon Brown and Alistair Darling be good news for small businesses? SMEs could certainly do with some respite. As the economic gloom has deepened during the year, even sound and profitable small firms have found it more difficult to raise the finance they need.

Even before the current round of traumatic events, culminating in the biggest bank share slump since the Great Depression on Friday, a survey had found that nearly a quarter of companies with between 50 and 199 employees had seen their cost of credit rise since the financial turmoil started in 2007. A further four out of 10 in the survey, conducted by Siemens Financial Services, expected the cost of borrowing to rise during the course of the present year.

The picture is reflected at the Federation of Small Businesses. "Almost half of our members have seen an increase in the cost of finance in the last year," says John Wright, the FSB's chairman. "It is crucial in these tough times that small businesses have access to fair overdraft and loan rates."

The key question is: after the bank rescue, will it happen? Despite the unprecedented action, which has seen the government take a 60 per cent stake in Royal Bank of Scotland and about a 40 per cent stake in a newly merged Lloyds TSB and HBOS, it is still difficult to say how the changes will play out from an SME director's point of view.



On the face of it, the bank takeover is encouraging. As part of the deal, which is witnessing nearly £50bn of new capital being injected into banks —£31bn of it to RBS and Lloyds TSB/HBOS— the participating banks have agreed to raise small business lending to 2007 levels. At this stage, precise figures are still unclear, but it wasn't until August 2007 that the credit crunch began and banks started hoarding their cash. So the full-year lending figures for 2007 will be way above those of the current year. This means that, in theory, there could be several billions now freed up to lend to small businesses. But there are still some rather large question marks over the whole arrangement.

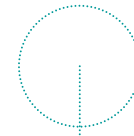
The first depends on what terms the banks will lend the money. They will be under pressure from the government to make lending at attractive terms to encourage take-up and reduce costs for small businesses. Last week's half per cent cut in interest rates will help, although Miles Templeman, the Institute of Director's director general, had called for a full one per cent reduction. But there is wide agreement among economists that further cuts could be on the way and base rates could be hovering between two and three per cent by the middle to end of 2009.

On the other hand, banks are under extreme pressure to keep their balance sheets strong, which means they will be looking both at the margin they can earn from new lending and the quality of their loan books. SMEs that can't demonstrate solid cash-flow could still find it difficult to raise finance.

The other factor is how far those banks that haven't taken advantage of new capital from the government will feel obliged to raise their small business lending. There will certainly be government pressure on them to do so, but unlike RBS and Lloyds TSB, they won't have a government nominated director on the board to prod them into action. So it could still be important for the government and business organisations, such as the IoD, to keep up the pressure of banks to lend to small firms on attractive terms.

"The government and institutions, such as the IoD, which look out for business interests must be vocal in the media in terms of what is expected from banks in the way of reasonable behaviour and fairness in commercial transactions," says Adrian Brady, chief executive of Eulogy!, a £3.6m-turnover public relations company.

And a further imponderable is whether, with a widely heralded recession just around the corner, many SMEs will want to borrow cash at the present time. When it comes to making loans, it takes two to tango, and some prudent businesses may wish to keep their borrowing costs low if revenue growth is under pressure.



A straw poll suggests that many SME directors are cautious in the present business climate. "What we need is for these measures to slowly filter through to the wider economy as quickly as possible to rebuild consumer confidence," says entrepreneur Tony Hayday, currently chief executive of the £1m-turnover Software Bureau.

John Capper, national head of audit and business services at accountants RSM Bentley Jennison, says that strong well-managed businesses may now find it easier to get credit. But he says that most firms have been hit by a "double whammy" of slumping consumer confidence and rising energy costs, which means people are spending less on "discretionary" items such as a new car or furniture.

"The knock-on effect on all other suppliers and the service industries which support these sectors is starting to take hold and will result in a deeper recession than previously predicted, more redundancies and more business failures," he warns.

The bottom-line on the rescue package is that some SMEs should find they have access to loan finance that otherwise wouldn't have been available. But this won't be an instant fix—loan applications take time to process and banks are now going to focus more on the quality of their loan book.

As far as the banks' own futures are concerned, the next couple of weeks could prove crucial. If the markets decide the measures taken so far are insufficient, we will move into previously uncharted economic territory.

However, the initial market reaction was cautiously positive—although HBOS and RBS shares lost ground, there was an overall boost to the FTSE 100. If the cash starts to flow again—even if it's only a trickle to start with—the worst could be over.

