Funding in uncertain times

As I write this, no one knows **whether the "green shoots" are real or imaginary. There seems to be conflicting economic data out there - UK economic output has contracted further and faster than was expected, unemployment is still rising (but at a lower rate than was predicted), house prices have risen in 3 of the last 4 months and completed house sales in May were at their highest level since last October.**

The technical debate on whether or not the economy is in Recession or if it's the "worst since..." is irrelevant. The fact is that, after millions of words having been written and spoken on the topic, no one has come up with a reliable analysis of how bad the "crisis" will be or how long it will last.

That's my cue for advising business owners and management teams not to relax, not even for a second. The business sector has experienced the "Credit Crunch" in a variety of ways over the last year - I know some businesses which have prospered, enjoying increased sales, and others where, unfortunately, the phone has stopped ringing and the business has struggled. This is all in an environment where the banks have been largely supportive of business, partly because they have learnt from previous downturns that over-reaction tends to be counter-productive and also, of course, as a result of political (or should we say "shareholder"?) pressure.

Whatever your recent experience, there is a real possibility that trading will become (even) more difficult over the next 12 months. Firstly, inflation will return, to some extent at least, and higher interest rates will impact on consumer and business spending power, again to some effect.

My concerns relate, therefore, to when things do start picking up again. Firstly, growth requires funding and I'm not convinced that the taps will be turned on quickly enough, even with the support of Government schemes such as the Enterprise Finance Guarantee. Perhaps more importantly, the banks may see an opportunity to realise value from their "hospital case" customers at that time - currently, there are a significant number of companies borrowings are greater than the underlying value (the business version of negative equity). In many cases, they don't need additional cash, however, and are surviving for the time being.

The potential problem is that it will take a long time for those debts to be repaid given the lower "post Recession" trading base but, as business value rises in line with the economy and general confidence, lenders may seize the opportunity to force a sale, often using an insolvency process. As an example, talk to any property professional and they'll tell you there are plenty of property situations where the bank hasn't pulled the plug as there simply isn't enough value to make it worth their while.

That process of debt recovery will destroy stakeholder value - jobs will probably be lost as the buyer of the business integrates its new acquisition and trading creditors will suffer losses. That may have an impact on even those businesses that haven't yet suffered reduced demand - as their own customers experience difficulties and trigger a knock on effect. Unfortunately, experience tells us that company (as well as personal) insolvencies lag behind the front-line economic indicators and are therefore likely to continue to rise both through the downturn and beyond.

CATHERINE KURTZ
Buy a dozen get the second dozen free 2009
Oil on board
40 x 41 cm

I'm fundamentally a positive thinker and my own business is all about giving constructive input, so please don't think me a doom-monger. We can only consider solutions, however, after recognising and appreciating potential problems. So, here's a 6-point plan for you to consider:

1. Ensure you maintain detailed cash flow projections, particularly if you are close to your borrowing facility limits - preferably updated weekly. By plotting each expected receipt and payment individually, these should provide a reliable early warning mechanism of potential problems.

2. It's important to also have a longer-term forecasting tool - a financial model - which you can use to update regularly where you think you're going to be in 3, 6 and even 12 months. This should incorporate integrated (i.e. linked) Profit & Loss, Cash Flow and Balance Sheet elements. Many businesses don't use such a tool but it comes into its own when additional funding is needed and presentations to financiers are required.

3. Keep a very close eye on your sales ledger. However long established or close the relationship with a customer, beware any (negative) shift in payment patterns, watch out for round-sum payments being made or unusual order sizes from them. Be particularly watchful of the most important customers - the biggest either in turnover or profitability terms - regardless of how robust they may seem.

4. If you feel you're going to need more cash or can't make a payment, take advice before talking to your funder but don't delay in doing so. How the situation is "packaged" when presented to a bank is very important - and the matter must be addressed as early as possible in case an alternative or additional funding source is needed. That will take time to put in place.

5. Bear in mind that HM Revenue & Customs - which is a significant creditor for most businesses - is being generally very supportive at present, as are many landlords. Again, professional advice will help you best present the case to get the optimum outcome for all.

6. Be wary of taking greater risk yourself - for example by providing a personal guarantee (or an increased one), mortgaging the family home, etc. We all wear rose-tinted glasses so far as our own businesses are concerned. Again, take advice.

Finally, it may sound counter-intuitive, but there is a lot of funding out there looking for good opportunities. Some of the debt funding community is back in the market and there is plenty of equity-based finance, although the latter is relatively "expensive" compared with overdrafts or asset-based finance. We all have to recognise that the banks have been providing an increasing amount of unsecured funding during the "boom" at secured lending rates, so we must expect a correction to the availability and price of funding as they are not (supposed to be!) in "the risk business".

I hope I'm wrong, of course, and that my concerns prove unfounded. Let's hope we have a "smooth landing" and a more prosperous 2010.

Clive Sanford is Managing Partner of Magus Partners LLP, a specialist Corporate Finance advisory firm focusing on Strategy & Business Planning, Raising Finance and Acquisitions & Disposals.

magus*

Email: csanford@maguspartners.com
Tel: 020 7317 0992
Website: www.maguspartners.com