The banks' appetite to lend to small businesses is very low

By **Dr Steve Walker**

It has amazed me over the last few months that the arguments are continuing with so little apparent understanding by many regarding access to finance for small businesses and also the cost of finance.

Reports and economic studies have for many years stressed that the most important point is access to finance rather than the cost for small businesses. Yet the Government seems to be obsessed lately with ensuring that the banks are able to lend at around 1 per cent less than they usually do.

Both their major schemes recently have more to do with helping the banks' liquidity than directly helping businesses.

Interest rates are related to the level of risk being taken and in the case of small businesses the risk is highest for the smallest and newest.

With over 80 per cent of start up businesses ceasing to trade within five years it is perhaps not too surprising that the appetite to lend to them is low. These are businesses which are also typically unable to offer any security – even more of a risk.

Usually those which are successful in obtaining funds are able to make their business cases well.

They are able to sell themselves and the viability of their plans to potential funders, demonstrating that they have sufficient self confidence in what they are doing to be taking some of the risk themselves and investing some of their own money.

In my experience all too few are able to do this. Of course even the best cases can fail for a variety of reasons, which further highlights the risk problem for funders.

The best cases are currently likely to be snapped up by peer lending funders at rates from 8 per cent to 12 per cent, but usually such loans are only available to businesses that have traded for over two years.

CDFIs, like ART, are now lending at rates between 10 per cent and 20 per cent, dependent upon the size of business supported and the risk factors, to businesses that the banks are unable to help.

The banks, if they will offer a similar loan at all – the majority are unsecured, are lending at rates in the range of 8 per cent to 23 per cent.

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What has now happened though is that we have some new entrants who are tempting small businesses with quick responses and easy access. The log book lenders and money shops are charging 100 per cent to 300 per cent plus for their access to finance.

And the latest new entrant is Wonga, which is offering short term loans at rates from 100 per cent to 2,000 per cent.

At this stage even Wonga is only looking to support businesses three years old with a turnover of £20,000 per month.

With a significant marketing budget, the company is certainly shouting louder than the CDFIs and others are able to, in an effort to let everyone know its offer exists.

My concern here is that small business owner managers, too busy to do the research, are likely to hear about Wonga, but not about the many other forms of finance open to them if the banks can't help – forms which would come at a much lower interest rate.

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The policy makers, media and business community need to understand what realistic rates small businesses can expect to see in the market. They also need to accept that the banks will not be able to lend to all.

There is starting to be an awareness that a healthy variety of alternative options is needed.

However, to take the risks required to achieve the social and economic impacts desired, particularly small business growth and job creation, the public sector, in my view, needs to have a greater understanding of the whole market and be flexible and creative in its solutions.

A 1 per cent reduction in the bank lending rate will cut little ice for the vast majority of small businesses who can't meet the criteria to access bank finance, even if they do have a viable proposition.