BUSINESSEUROPE

SPEAKING NOTES

GO FOR GROWTH
AN AGENDA FOR THE EU IN 2010-2014

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SPEAKING POINTS FOR HUGH MORGAN-WILLIAMS
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Background

1) Autumn 2008: an outbreak of terror. Banks face financial meltdown and financial inadequacy. SME's bear brunt of pain as they represent higher risk on lower capital ratios.
2) There is a credit famine, and when banks start lending again or renegotiating loans prices become high.
3) Today whilst credit is no longer impossible to obtain its price is high compared to the price banks themselves pay for their capital. When interest rates are as low as a half or one per cent, companies are paying not just a bigger margin to banks but the negotiation arrangement fees are higher as are breach of covenant fines. (A couple of UK examples)

Adequacy of government response

1) It was slow. Some countries gave guarantees to their banks; others took some of the banks over (in effect nationalised them)
2) All governments have increased their regulations on banks as a result of the market failures. But rules on greater capital ratios make it harder for banks to fulfil their lending functions, as they have to retain more capital in reserves rather than lending it. I would argue that more time is needed for institutions to build up their capital ratios, and in the meantime we should rely more on national guarantees to banks.
3) Regulation is a blunt instrument. It always attempts to bolt the door after the bank robbers have gone, and cannot foresee the future. That doesn't mean than no regulation is necessary, but too much will deprive the market of funding, and make the access of finance to SME's more bureaucratic and burdensome.

Current situation

As Europe slowly emerges from recession, credit is becoming more available, but I would ask two questions.

1) Do the banks have sufficient liquidity to help SME's with the working capital necessary to come out of recession?

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2) What price are banks charging to provide this liquidity in respect of the low interest rate regime across the eurozone?
   Whilst the interest rate might not be too high, other charges are being devised to make the effective interest rate very high. It may be that recovery will be slower because credit is not cheap enough to encourage firms to invest in the future. This is likely to worsen Europe's competitive position in relation to Asian economies.
3) SMEs tend to be at the forefront of this argument because generally they do not borrow large sums; they have little lobbying power with banks and governments; and are considered a soft target by lenders.
   So yes I would agree they are not being treated fairly. But should regulation play its part in forcing banks to lend in a fairer way to SME's or should there be enablement and encouragement instead?
4) As a result of this situation companies themselves are increasingly reluctant to borrow. They have discovered that in good times banks are happy to lend them an umbrella. They have also found that banks want it back as soon as it starts raining. There is as a result a bigger demand for equity. In the north east of England we have launched a 125 million pound equity portfolio of funds backed by the EIB, and demand is running ahead of projections. Business Angels in London are telling me they can only fund five per cent of the backable propositions being presented to them.

Areas for future policy action

1) Adoption of IFRS for SME's will lead to greater bureaucracy and accounting hurdles for SMEs. I do not believe it will assist in access to finance. It is management that wins investment not bureaucracy and statutory accounts on their own.
2) Prompt payment. This is currently being debated within the Parliament, and whilst it is outrageous that payment times of over 400 days are not uncommon in some parts of Europe; to interfere with the freedom of two parties to negotiate payment times should not be thrown away lightly.
   Again we live in a global market not just a European one. We need to be careful that we do not give our competitors outside Europe yet more advantages.
3) Capital ratios of banks should be increased gradually not imposed suddenly, as this will distort and limit the availability of funding for SME's
4) Maybe the establishment of a Europe-wide intervention task force which can be called upon in times of emergency similar but more local in scope than the IMF might be a good idea.
5) Banking should be looked upon as "boring". It is an essential part of our economy but one of the reasons why we got into the mess is that banking became sexy and exciting. Too much temptation, and not enough sobriety!

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