GET YOUR BUSINESS LENDING DUCKS IN A ROW

CURRENT MARKET CONDITIONS ARE RIPE WITH OPPORTUNITY FOR THE BUSINESS SECTOR, SO HOW CAN BUSINESSES NAVIGATE THE LENDING ENVIRONMENT TO FACILITATE GROWTH? *TOTAL PROPERTY* TALKS TO INDUSTRY EXPERTS TO PROVIDE CONTEXT.

WHAT 2020 AND THE ONGOING ramifications of a global pandemic have shown in the New Zealand business sector is that pre-COVID, there was complacency in the marketplace.

Jayson Hayde, Bayleys national director business sales, says bluntly: "the changed market conditions and ongoing challenges have sorted out the weak from the strong".

In 2021, it's all about a reset and recognising opportunities.

"While no-one could have comprehensively prepared for the unparalleled curve balls that were thrown at us last year, it has since given weight to the phrase 'never waste a good crisis'," says Hayde.

"Preparedness is crucial, along with the ability to turn on a dime and adapt.

"There have been lessons for everyone across the business sector and now, with a line drawn under last year, we're seeing more strategic planning and revision of business plans and an acceptance that transparency and a 'cards on the table' approach is the best way forward with stakeholders."

Hayde says businesses are facing tougher scrutiny from banks and while there still seems to be a lot of cash in the market thanks in part to Government stimulus packages, when a business needs to access capital – they'll need to be well-prepared.

"Our business clients have been turning to Bayleys' advisory teams for advice around strengthening their position with lenders and we can help with clear messaging to ensure the case they present to the bank is comprehensive enough to meet thresholds and convincing enough to be considered.

"It is getting back to relationship-building and the more we can do with business owners to help identify the strengths of their business asset, the more effective they will be in front of their banker.

"And on that note – changes within banks and to regulatory models means that often, businesses may not be dealing with a banker they've dealt with before so it will come down to the facts and how the business case is presented."

Economist Cameron Bagrie of Bagrie Economics says banks are naturally being more conservative with lending given the economic environment and he expects COVID – and keeping it out of New Zealand – will dominate the economic narrative for 2021.

"Given we reside in a globalised and connected world, and the world continues to be disrupted, we must brace ourselves for ongoing challenges.

"Being surrounded by a big moat has helped keep COVID (largely) out of New Zealand and aggressive policy steps by the Government and Reserve Bank has seen the economy bounce back more sharply than expected.

"However, we can only remain reliant on Government spending – or more correctly, borrowing massively – for so long.

"Ultimately businesses will need to be investing."

Bagrie says the economic and social ledgers have become increasingly unbalanced, with housing the key culprit and he feels the current lending mix, with booming home lending and shrinking business lending, is worrying.

"That mix will not grow a productive economy, so it is critical that banks take a long-term approach.

"Some sectors – like tourism – are getting more scrutiny than others, as forecast revenue is difficult to project, and sometimes this will require banks to take a deep breath when doing deals."

Bagrie explains that businesses are also being pretty cautious, hence we're not seeing huge demand for credit.

JAYSON HAYDE, NATIONAL DIRECTOR BUSINESS SALES, BAYLEYS

"We have seen a $13 billion rise in non-financial business transaction deposit balances in the banks.

"Some of that is switching out of term deposits, but it looks like firms are wanting access to liquidity and waiting for opportunities to emerge and uncertainty to disappear."

Bagrie says expectations are that inflation and interest rates will remain low, but he sounds a word of caution.

"Inflation rising could be a key surprise and while we have inflation suppressants, a lot of forces are also pushing inflation up."

Bagrie says businesses wishing to secure bank finance for growth must get their business ducks lined up.

"You'll need to have a compelling story and more information is better than less.

"Make sure the business financials are up to date and in good order, have a business plan including comprehensive budgets and cash flow, and know all the details of your personal financial situation.

"Develop a good relationship with your banker who will hopefully take the time to understand you and your business – this relationship will be founded on trust."

Having good financial systems and processes in place and ensuring you are on top of key business risks, including debtor management and cyber risk, will be invaluable and Bagrie recommends using a third party to help with financial planning if needed.

With close to 30 years of wide-ranging international business experience, Gordon Stuart is a business coach and facilitator with The Alternative Board working with businesses in central Auckland.

CAMERON BAGRIE, ECONOMIST,
BAGRIE ECONOMICS

He says we need to look at what makes the banking sector tick when assessing a bank's appetite for business lending.

"Banks are regulated by Basel II and Reserve Bank of New Zealand (RBNZ) Guidelines to protect consumers and investors and are required to carry and exceed minimum capital ratios to reduce the risk of loss.

"Unfortunately, what is best for the bank is not necessarily best for the economy.

"Regulatory measures, credit risk weightings and low interest rates have fuelled large mortgage lending growth over the last decade.

"With the RBNZ requiring higher levels of capital to be held by the Australian banks here in New Zealand going forward, the ship has tilted further away from corporate/commercial property, SME and rural lending, towards growing their mortgage books."

Because of these factors, Stuart explains that for a bank to receive the same risk-adjusted return on capital from a business loan as it does on mortgages, it needs to price business loans higher.

"In addition, business lending assessment is more complicated than formula-based residential house mortgages as every business is different, requiring more skilled staff, and more time to make the credit assessment," he says.

"If you're planning to take out a business loan, you will get a tougher grilling from your lender than in the past because the Anti-Money Laundering laws and Responsible Lending Code now require banks by law to ask much more detailed questions before giving credit.

"They need to be satisfied that the credit provided will meet the borrower's needs and objectives and that the borrower or guarantor will be able to make the payments under the loan, or comply with the guarantee, without suffering substantial hardship."

While the changes aim to prevent consumers being locked into loans they can't afford or have little hope of repaying, these compliance hurdles have added to the banks' cost base often resulting in frontline bank staff cuts which in turn leads to longer approval turnaround times.

Stuart outlines seven common mistakes small businesses make when dealing with banks:

- Focusing too much on price and not enough on conditions, headroom (i.e. surplus facilities) and covenants
- Communicating too late – address potential problems sooner *
- Failing to recognise a banking relationship is a risk-management issue
- Having all your eggs in one basket
- Overestimating the value of loyalty and track record
- Failing to get independent advice and/or not reading the fine print
- Over-promising and under-delivering

* Banks are looking for confidence in your management team so if you have a problem, firstly you need to explain why it happened, what the impact is, what you intend doing about it, what you need from the bank and how you will pay the bank back.

Remember banks are not in the business of taking risk – they like at least two ways to be repaid – cashflow from trading, sale of assets, or recourse to security.

For most small businesses this means a General Security Agreement over the business supported by lending secured over the family house, which has the double benefit of reducing capital required against the loan.

Stuart says businesses should look at whether they can leverage against the family home to provide cheap money for the business to grow, as new equity is more expensive than debt and can mean a loss of control.

Growing businesses can bring challenges for staff, systems, working capital, gross margin management, labour productivity and fixed costs. A common outcome of growth is the need to refinance.

"Remember, banks like to see the ability of a business to repay debt after it has been increased, so a clear plan demonstrating repayment and how you intend to mitigate all the different risks is needed," Stuart emphasises.

He says banks hate a vacuum, so clear and regular communication is paramount and when explaining your position – "keep it simple stupid" is the best policy.

"If possible, use a business lending broker/former banker to act as an interface or negotiator to help you, and develop a range of scenarios to present and prepare your case.

"You need an appropriate credit story supported by both historic and forecast financial scenarios – this takes time and expertise.

GORDON STUART, BUSINESS COACH
AND FACILITATOR, THE ALTERNATIVE
BOARD AUCKLAND CENTRAL

"Bank jargon can be baffling and a third party with experience will help you understand the bank's requirements and needs."

Stuart adds that low interest rates narrow bank's net interest margins.

"Banks are now under profit pressure from boards and shareholders, so the prospects for business lending are the brightest for several years."

"COVID has taught us to expect the unexpected, so maintaining liquidity is key as running out of cash is what kills your business first.

"If you are well prepared and can avoid the common mistakes described above, your prospects with your bank/s will be considerably enhanced."