

Time for a new financial world order

[Feb 12 2009](#) Agenda By Paul Kalinauckas

Now the country is officially in recession, the rules of the finance game have changed and it's important for businesses to know how to get through this to the best of their abilities.

The United Kingdom's economy is built on small businesses. Until very recently, many small and medium enterprises (SMEs) have bounced in and out of their overdraft facility to enable them to run smoothly.

In the good times, they'd have taken out healthy dividends and managed their businesses according to the ebb and flow of their sector. It's now a different game and we are witnessing perfectly viable businesses having their financial arrangements pulled or varied to reduce their overdrafts, some without notice. That's a practice that can kill a viable business stone-dead in 24 hours.

We created the Black Country Reinvestment Society in 2002 as a loans facility for SMEs and I'm thankful that we did – to start it now and attempt to cope with demand would be too difficult. We've witnessed this recently with other services that the Government has worked hard to get up and running.

Businesses are calling banks and requesting their share of government-injected funds, but it takes time for finance to filter through and many companies are too deep into a financial crisis for this funding to help them in time.

Banks have severely damaged the economy by their behaviour, but they are commercial lenders. They've done it before and past behaviour is a prediction of future behaviour. However, it's easy to understand why they are doing it.

In recessionary times, making loan finance available at high-risk doesn't make commercial sense, but banks have damaged the economy even further by denying funding to well-run companies who are blameless in this crisis.

The problem lies with businesses that are successful and well-run and are still having their overdraft and loan facilities withdrawn, even after they have managed them successfully for several years. Not only is this short-sighted, but it will also flatten a business that would otherwise thrive and prosper, adding to dole queues and social deprivation while stunting the economy. But, historically, that's what banks do in a recession.

What we must do now is look at what has gone wrong, learn from it and then look at developing a new range of financial instruments to steer us through this period.

It's important to develop mutual loans funds run by local, accessible people, for local businesses with support from the public, private and mutual sectors. Since going into recession, the business federations are saying they want banks to judge businesses' requirements on a case-by-case basis. That's what we as a mutual have always done and we believe our time has come.

We must be analytical and question how we can make our funding models work better. For example, BCRS could lend more money in the Black Country and South Staffordshire if we could access more capital, some of which could come from European funding, but which requires public-sector match-funding. So if the local authorities put money into BCRS, we could double it straightaway.

Since we came into existence, local authority input in terms of providing BCRS with capital has been zero, so even in the good times we were unable to access finance from them. But we have developed a business model that can preserve jobs and drive the economy; if we were able to tap into more capital, we could make a significant difference.

The appropriate use of our finance is not to replace banks pulling overdrafts; as niche players, we provide access to finance and will lend up to £50,000 to small businesses to enable them to create wealth.

We are now receiving approaches from brokers, accountants and business advisers who can no longer access finance from the commercial banking sector.

Previously, the emphasis was on creating new jobs and start-ups; it's now changed to job-preservation. BCRS is being contacted by profitable companies with a £3-4 million turnover and upwards of 40 employees, but who have reached a cashflow crisis that could take down the company down for the sake of a very small amount of money.

New technology has made it simpler for the banks to operate a tick-box approach to evaluation. However, that's now backfired, in that it requires a degree of competence in commercial relationships to be able to operate through a recession.

We can take a higher risk than banks because of the nature of our business model, while large corporations will always find it difficult to move as nimbly and swiftly as a small mutual.

Now that easy credit has gone, businesses must also learn a new approach to survive. We base our lending criteria on character, not just assets. There is now a much greater need for partnership working and this is based on the ethos of the mutual model. The principle of mutualism means that the focus of the transaction is for the benefit of the customer, not external shareholders.

BCRS has a well-established funding pipeline and we have tripled our lending last year. Our mission has always been to back people in the Black Country and South Staffordshire, who need assistance in growing their business, but they have to make a sensible case for it.

If a borrower runs into difficulty, it's imperative that they don't adopt an ostrich mentality. They have to talk to their lender. We carry out quarterly checks and if they approach us early enough, we have the flexibility to adapt.

It's critical that our clients make full use of the funds they have from us and that's down to them being good-quality clients with well-run businesses. We are now doing better quality loans to companies who were previously served by the commercial banks.

BCRS is constituted as an Industrial and Provident Society, owned by its members. Anyone can join by subscribing to withdrawable share capital, which forms the basis of our loan fund.

They can obtain community investment tax relief for placing money with us, but mainly they do it because they are committed to the region and believe in our mission. In addition, we can raise funds from the banks, but we have to pay it back, so we have to ensure that the people we lend to can do the same. It's simple housekeeping.

However, without some public funding we couldn't stay in business. Advantage West Midlands has been superb in ensuring there is a mixture of member, commercial and public-sector development investment, but we still need to increase and vary our income streams.

Mutuals are the future. It's important to build small funds that are driven by the need to provide access to finance, not to make trillions for shareholders who are not party to the transaction.

I believe the Government is missing a trick. BCRS came about through a policy to introduce a range of financial instruments that could be delivered locally to areas of high deprivation.

That was a bold move and we have now created a pipeline of funding into local communities. But the Government needs to push more capital down that pipeline. We tripled our lending last year and could double that again in 2009.

We employ ex-commercial bank lenders and give them the opportunity to use skills that they could no longer use in commercial banking. The emphasis is on due diligence, thoroughness and relationship-building, managed locally.

I want to see the Black Country become great again. I remember when Bilston was the most profit-generating square mile in the world. We have some amazing people here – if we can just do our bit by providing access to finance.

* Paul Kalinauckas is chief executive of Black Country Reinvestment Society (BCRS), a community development finance institution run on a not-for-profit basis.