

# Global Economic Downturn fact sheet

## Debt funding

### Series 1 – Issue 5

As part of the Institute's ongoing efforts to provide members with guidance and information on key issues affecting the current business environment, the Institute have developed a practical factsheet series, which presents guidance for members written by members.

'There has been a strategic shift away from the gaining of new business to managing risk within existing clients.'

## Banking on relations

**Peter Sullivan CA, Managing Director, Bespoke Finance**

In the space of two years, the market for debt finance has changed from one that can be described as 'available, growing, competitive, confident' to that of currently 'restricted, survival, limited, concerned'.

The businesses that adapt now to this economic and financial reality will be in the best position to ride out the present economic cycle.

In 2008, the headline stories were about the highly geared companies failing. In my opinion, 2009 will be the story of many good businesses failing or being severely restructured due to nervous bankers and lack of access to debt finance.

This factsheet will explore ways for businesses to survive and prosper by understanding:

- > The changing attitude of banks
- > The current state of the market
- > How to keep or increase your debt facilities.

### Attitude of banks

Within the business and corporate divisions of banks, there has been a strategic shift away from the gaining of new business to managing risk within existing clients. This has been mirrored by the power shift from the relationship managers to the credit analysts.

The past six years were characterised by banks aggressively gaining new customers and lending more to existing clients. It was an extremely liquid and competitive environment.

Today, bankers want to know more about their clients. They are focused on understanding 'whom did they actually lend to', 'why did we lend to them' and 'are they still a good risk'.

This is evidenced by the formality of account review meetings, the insistence on receiving and analysing quarterly accounts and the active repricing of loans.

Businesses need to manage their banking relationship and keep the bank informed. 'Surprising' the bank with news that should have been discussed months ago will only fuel the belief that the business is not well managed and is more risky.

For those businesses looking to refinance with another lender, the market is tough. All lenders will ask, 'why won't your existing bank do the deal?' The days of having competitors willing to lend more at a lower rate have disappeared in the current liquidity constrained environment.

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### Be prepared

Matters that should be reviewed and considered in any negotiations with a bank are as follows:

1. Financial position – adequate interest cover (at least two times), Debt to Earnings cover (three to five times), monitor debtor days and stock days
2. Financial information – up to date externally prepared or audited financial accounts and tax returns, rolling 12-18 month budgets, rolling 12 month cash-flow forecasts
3. Covenants – test compliance with bank facility covenants monthly, test covenants against the monthly profit and loss and balance sheet forecasts in your rolling 12-18 month budget
4. Communication – keep the bank informed of what is happening in your industry, market and business.

Bank funding will always be available for well managed and profitable businesses. In the current environment that funding will come at a price.

### Current state of the market

Accessing and keeping finance facilities is more important than the price of finance in this market.

The balance of power has shifted from borrowers to lenders. Lenders now have more requests for finance than they can fund. They can choose to fund the better margin and less risky deals, while reducing exposure to existing clients that fall outside their risk profile.

The reality of this is that some businesses and investors will not obtain funding. Others will be forced to partially or fully reduce current facilities.

To understand the competition for funds from banks, we need to appreciate the effect of the financial crisis in the Australian market:

- > Many of our largest companies had previously raised funding directly from the capital markets. This is now very difficult and expensive, so these companies now need to access funds via the banks
- > Many of the foreign banks operating in Australia are retreating to concentrate on their 'home' markets
- > The non-bank lenders, which serviced the commercial property market, have effectively disappeared
- > The cost of funding for our second tier banks is more expensive than for the 'big four' and so they have slowed their rate of lending.

The effect is that our 'big four' banks in Australia are carrying a tremendous funding responsibility and their assessment criteria and pricing is reflecting demand and risk.

Many CFOs, financial controllers and external advising accountants have not experienced an environment like this before.

As an alternative to debt, many large publicly listed companies are raising capital through equity markets to fund operations or reduce debt. While this is another way to raise capital, it is not always practical or palatable for the SME market to entertain outside investment, as the SME market is very reliant on debt funding.

### How to keep or access debt facilities

A bank needs to easily understand that the business is a good risk. It is important for a business to continuously highlight that you can comfortably **service** the facilities and that there is sufficient **security** if the facility needs to be exited.

This is where a well written and supported finance proposal or annual review document can assist to stand out from other applicants or customers.

For more information, guidance and tools on the global economic downturn refer to [charteredaccountants.com.au/news\\_issues/global\\_economic\\_downturn](http://charteredaccountants.com.au/news_issues/global_economic_downturn)

### About the author

Peter Sullivan CA is the founder of Bespoke Finance a leading finance consulting practise in Brisbane. This practise undertakes reviews, restructures and renegotiations of existing business and investment facilities and arranges funding for new transactions for clients mainly in the \$1M to \$50M range. Bespoke Finance assists business owners to get their business 'finance ready'. There is a strong focus on cash flow modelling, business strategy and planning the finance needs for the business and the owner.

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