Banking & Payments Federation Ireland

Banks and SMEs: the business of lending and borrowing

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Banking & Payments Federation Ireland (BPFI) is the voice of banking and payments in Ireland.

Introduction

Banks want to lend money to businesses – it’s what they do. Embedded in their purpose is a commitment to help businesses grow and to support customers both in a thriving economy and through challenging times. It is a core part of each bank’s offering to support business customers – success for the customer bodes well for the lender. It is also important to their wider stakeholder groups, including shareholders (which includes pensioners invested in pension funds); and to their generation of a fair return on capital so that Banks can sustain their future business and their ability to lend. In essence, banks regard SMEs as a core and strategic part of their business and they invest heavily in supporting SMEs through their people, their technology, and their sector specific supports.

The principles of lending and borrowing

However, lending money to businesses is a risk- based business the world over. It is important that banks deploy the rigour of risk assessment to all customer requests for loans, including lending to business borrowers who seek loans in the firm belief and with full intent that they will repay them. Portfolio analysis and experience nonetheless shows that a certain percentage of all loans will not be repaid in full if at all. Thus, the process of understanding customers, their business and the risk and opportunity in their business is a critical part of banking. In order to secure finance from a bank, a business has to engage fully with the bank to explain its proposal and its benefits to the business, so that the bank can readily assess that the proposal ‘stacks up’. The bank will also want to be satisfied that the customer has a good track record to date in terms of repaying loans and in running the business, has the management capability, staffing and key resources to run the business and ultimately, the repayment capacity to repay the loan.

In this engagement, the bank will also seek to ensure they structure the loan (term, amount, conditions, type) to optimise its fit for the customer. Knowing their customers and their businesses is the best way the bank can ensure the customer receives exactly what is needed for the business (even though sometimes, this may differ from the customer’s initial request)

Banks in turn have legal and business obligations to carry out credit assessments to gather and record sufficient information from the borrower to assess whether the credit sought is suitable to that borrower. A bank should only offer a credit facility where it has satisfied itself that the borrower will be likely to repay the debt over the term agreed: to do otherwise would be a disservice to both. So, banks and borrowers each have obligations to each other. To help them fulfil those obligations, businesses need to provide comprehensive information to lenders; and lenders need to be clear about their information requirements so that the process can be as straightforward, timely and streamlined as possible for the customer.

Information required

Below are the key areas of information* for SMEs to provide when requesting new loan facilities from your Bank

- ** Note – if you have a long-standing relationship with your Bank and are looking for a short term facility (or indeed a renewal of a facility), you may not need all of this information. At a minimum you will need your trading / financial information and an explanation of what you are seeking to do with the funding in all cases.*

1. Your Business Plan

A well- prepared Business Plan is vital to any credit application. Often businesses only provide financial data, but ideally a business plan for 'new monies for a new project' should also set out the following, in summary format:

- Details about the ownership and management of the business
- A Summary of what the core business is about, i.e. what you do and what is the unique selling point of your business. Outline the key opportunities, challenges, and potential risks for the business and how they are managed/mitigated (customers, supply chain, key staff, exchange rates, finance etc)
- Market and sector challenges and opportunities (position in the market, competitors, pricing, trends, technology impact & use)
- The trading history of the business, current operation, and future plans. This would normally be in the form of a three-year trading history of the business (ideally audited financial accounts and latest management accounts - including Balance Sheet, Profit and Loss Account and Cashflow). If the business is not trading that long, then trading to date then becomes the time period for assessment.
- The future financial projections of the business are also important and are dealt with separately in the next section.

2. Financial Performance/Projections

Providing the information needed by the bank to assess the credit request is very important. The information required will depend on the size of the business and the size of the loan request:

- Up-to-date financial and management accounts (as outlined above)
- Cashflow projections/Projected Profit & Loss Account showing that the business has the necessary repayment capacity to meet financial obligations – usually for a minimum of the time period of the loan term
- Provide underlying assumptions for any projected growth, e.g. new contract etc.
- Up-to-date aged list of creditors/debtors
- Asset/Liability profile
- Tax Compliance / Status with Revenue
- Details of any other Loan Facilities, Term, Provider, Special conditions

3. Details of the Requested Loan Facilities

- Details of the purpose of the credit facilities sought, how much is needed, how that figure has been arrived at, the nature of the credit and how long it is expected to take for the business to repay the loan.

- Outlining the additional capital invested in the company is important, including additional monies to be invested (and the source of that investment) to support the purpose of the credit facility sought.

- The repayment capacity of the business to meet the loan repayments on the facilities sought is critical – this is dealt with through the Financial Projections, demonstrating how the cashflow will be generated to repay the loan within the agreed timeframe

- The security that is available for the loan if required.

Strong Credit History

- Maintaining a good credit history is very important. Good operation of a business current account is a key factor as it demonstrates financial management and that the business is in control of its finances. Even when this isn't going to plan, an early discussion with your bank will demonstrate that you are dealing with your issues 'head on', and you can arrive at a good outcome with your bank up front, demonstrating practical discipline and focus in managing your business. This early discussion will also avoid you having to deal with, for example, unpaid direct debits/cheques and other key bills. This is important as these raise 'red flags' automatically on your accounts and impact on behaviour scoring/predicative scoring models used by banks to assess risk based on the pattern of behaviour observed.

- Credit reports are a good indication of likeliness to repay, as they reflect previous performance on loan repayments. Banks are obliged by law to submit information about repayments made or missed each month to the Central Credit Register. It is also compulsory for banks to check a potential borrower's credit report in the Central Credit Register when they are considering any loan of €2,000 or more.

- In short, the better a business's credit history, the more likely the business is to be successful in its credit application

- In addition, there are now very strict guidelines governing the 'Unlikely to Pay' status of a business which all banks must adhere to. Early engagement with the bank can help a business to remain in the 'Likely to Pay' status bracket and also – if they are by necessity in the 'Unlikely to Pay' status bracket - they can work with their bank to exit this position as soon as possible.

Tax Affairs

- Many businesses need a Tax Clearance Certificate to operate. If they do not have this, it may hamper their business opportunities with a knock-on effect on their financial performance.
- If a business is behind in PAYE/PRSI, VAT. RCT, Income or Corporation tax payments etc, then this will need to be addressed during the credit application process. Similar to having a good credit record, a good record in paying Revenue tax obligations is very important.

Engagement between borrower and lender

- Lenders start out from a position of wanting to meet loan proposals with a positive response and will do their best to guide businesses through the loan application process to that end. The better the quality of information provided to the bank, the easier this process will be. The more open the engagement between the lender and the borrower, the greater the likelihood of an agreed approach to the credit sought. However, it has to be recognised that sometimes this may mean a different mix of facilities or that a lower level of credit may be more appropriate to the repayment capacity of the business.
- It can also be helpful for businesses to consult with their accountant or financial advisor to review any proposal in advance of meeting with a lender, or for their advisor to attend the meeting with the lender.

Primary reasons why borrowers are not successful in their Credit Applications

- Lack of repayment capacity/Inadequate cash flow
- Outside the lender's credit risk policy/risk tolerance level
- Sufficiently indebted already/Limited collateral
- Inadequate information
- Poor credit history/Missed repayments

In a situation where the bank is unable to lend to a customer, it is quite possible that the customer may be able to borrow under one of the State- supported schemes such as the Strategic Bank Corporation of Ireland (SBCI), Microfinance Ireland (MFI) or Enterprise Ireland. . Where a bank is unable to lend to a business, that business should ask whether any other schemes are available to support its needs, or indeed in what circumstances, if any, the bank will reconsider its decision.

Where an SME borrower has submitted a formal business credit application which is refused, reduced or withdrawn by a bank, they have the right to appeal this decision through the lender's internal appeals process. If the appeal is unsuccessful, the borrower may be eligible to appeal their case to Credit Review . This is an independent government-financed service that accepts requests for review of a bank's credit decisions for facilities between €1,000 – €3,000,000.

Useful links:

- https://www.revenue.ie/en/starting-a-business/index.aspx
- https://www.centralcreditregister.ie/
- https://sbci.gov.ie/
- https://microfinanceireland.ie/
- https://www.enterprise-ireland.com/en/
- https://www.creditreview.ie/
- https://business.aib.ie/
- https://businessbanking.bankofireland.com/
- https://digital.ulsterbank.ie/business.html
- https://www.permanenttsb.ie/business-banking/
- https://www.dolearnfinance.com/

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