

Small Businesses – climbing out of recession
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We all know the UK is in a period of very difficult economic conditions. The government recently predicted in the budget that we will see public sector borrowing account for 12.4% of GDP.

That is a frightening figure – but even more worrying is that this has been called ‘optimistic’ by many commentators.

So what’s the outlook for SMEs (small and medium sized enterprises)?

A few commentators believe we are through the worst and cite a ‘U’ shaped recovery for the UK, while others are predicting a W shaped ‘double dip’, basically a short but unsustainable recovery while business restocks.

Whatever the shape of the recovery, whether it is U, V or W shaped, we know that it will be tough. Trading conditions will continue to be difficult. There will continue to be a lack of available finance from risk-averse lenders and there is a real likelihood that we will face higher taxes from whichever political party wins the next election.

Given that small business account for 98% of all enterprises in the UK, it will be this sector which will help lead the country out of recession. But is the SME sector currently in a fit enough state to effectively kick-start the economy?

Many SMEs outside the financial, property and automotive sectors have not felt the same pain as larger businesses. Many continue to have good orders, profitable work and, if finances were pre-arranged before the clampdown by the banks, many have little difficulty in continuing financial arrangements.

The outlook is difficult but workable. Strangely, where the greatest challenge to SMEs lies is when the economy begins to recover.

The climb out of recession is the time when the greatest number of businesses fail. Those failures are not caused by poor sales or losses – many of those businesses that fail are profitable and expanding.

Rather, the reason is simple: a growing business needs increased working capital – it needs cold, hard cash. Cash to fund the next sale, cash to fund the next increase in turnover.

A lack of working capital can lead to over-trading. Despite increased turnover and profits a business may not generate enough cash to cover its daily needs. It’s a risk all companies face.

If a business has a conflict between profitability and cash flow, it must choose cash flow every time.

Being a profitable growing company also means a business has greater need for finance. As turnover grows, so stock grows along with the money owed to suppliers, tying up increasing amounts of cash in these areas.

So where can businesses get the finance they need to survive the upturn?

Banks are being tougher on businesses – reviews are more common, renewals tougher and banks are demanding increased security or other guarantees, suggesting shorter repayment terms or alternative finance options.

Banks want more information, projections and plans and on a more regular basis. If they don't like what they see, or don't see what they expect, they are increasingly likely to withdraw facilities.

Despite that, the British Bankers Association (BBA) figures show high street lending to non-financial businesses increasing by £100 million in May, but that was after the slump in April of £2.3 billion.

Finance is out there. Businesses needing extra capital can look to peer groups or to venture capital. This venture capital comes from two major sources – business angels (think Dragons' Den without the cameras) or Venture Capital funds.

These individuals or funds put up money for shares – and they risk losing the money if the project fails. Demand for funding is increasing and there is less money available, but people still want good businesses to invest in.

There is also the option of government support for business. Many of the schemes have had poor take-up, are confusing for businesses, or simply can't be effectively used by established or growing businesses.

However, the support that does work, and is being used, is the Business Payment Support Service run by HM Revenue & Customs. This service allows the advance deferral of business taxes including VAT, PAYE, and National Insurance contributions.

So far 141,000 businesses have participated in the scheme, deferring £2.5bn in taxes. The most popular deferral is VAT which accounts for 42% of the take-up. Other government support includes the Enterprise Firms guarantee, which loans from £1,000 to £1m and runs up to 31 October 2010.

Given the current recession, what do small businesses need to think about, and what should they do differently?

The simple answer is that nothing should be fundamentally different – the basics always apply in good and bad times: good liquidity, good client relationships, being able to maximise profitability and having a plan. And lastly, businesses must be flexible, and take advantage of opportunities as they arise.