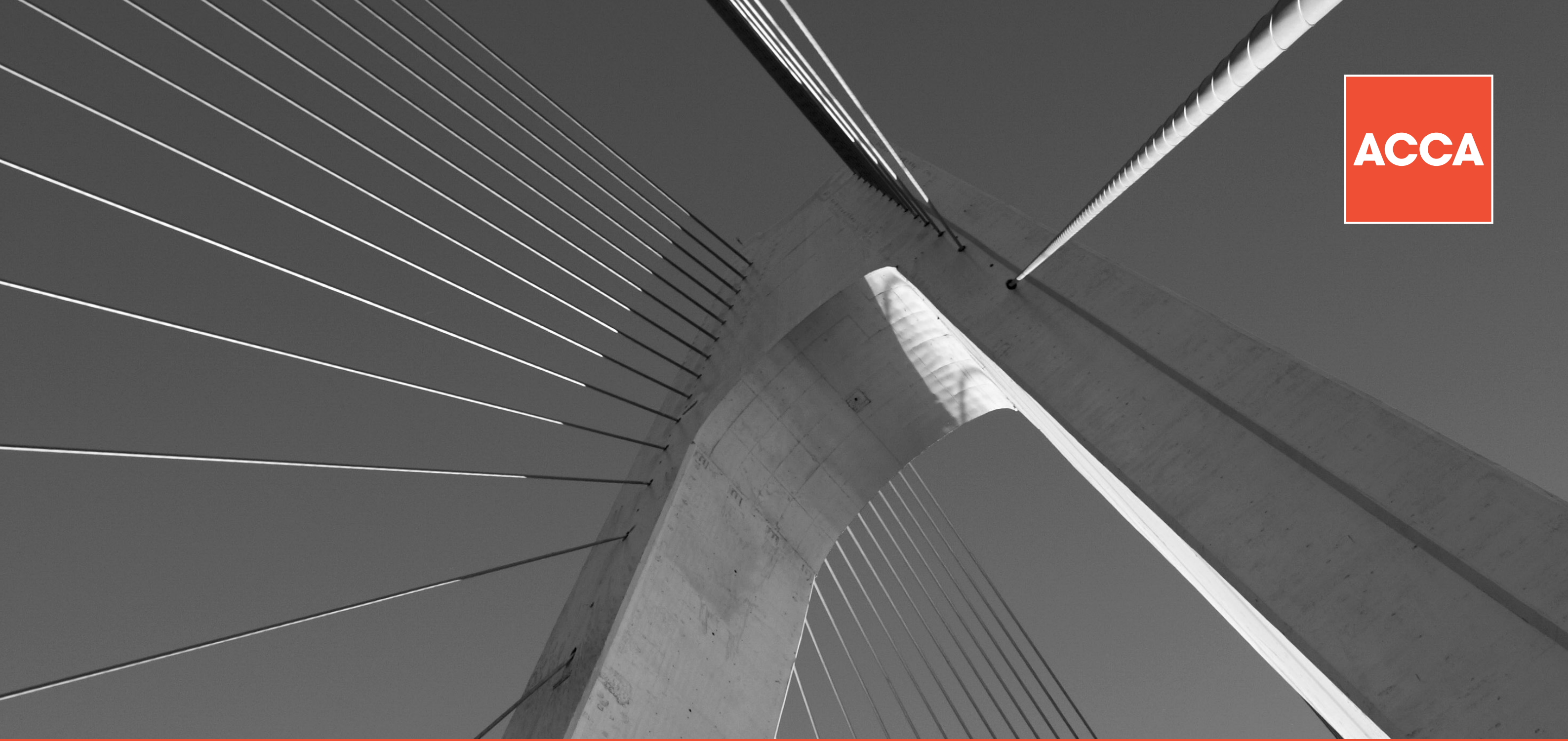

ACCA

The state of business finance

PART 3: REFLECTIONS ON THE EVIDENCE

This report was produced in association with Longitude Research

Longitude

About ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

We support our 170,000 members and 436,000 students in 180 countries, helping them to develop successful careers in accounting and business, with the skills needed by employers. We work through a network of 91 offices and centres and more than 8,500 Approved Employers worldwide, who provide high standards of employee learning and development.

This is the third in a series of three reports on the state of business finance worldwide.

It summarises ACCA's findings and issues a call to action for governments, the financial services industry and, most of all, finance professionals around the world.

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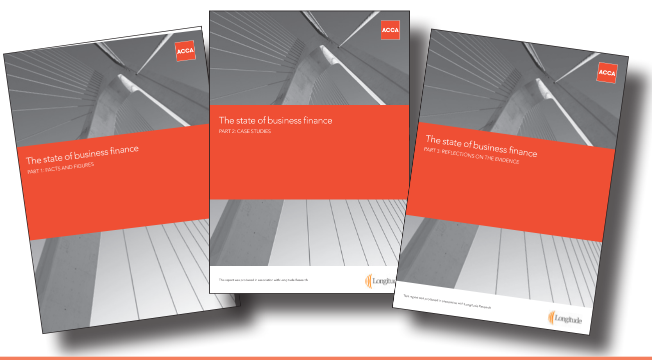
The state of business finance

ACCA's review of the state of business finance is an ambitious global investigation into the challenges faced by businesses when trying to raise finance and the ways in which finance professionals in industry, practice and financial services help them along the way.

The outcomes of this review have been presented in three reports.

- *The State of Business Finance, Part One: Facts and Figures*, presents an analysis of two sets of quantitative data taken from the ACCA–IMA Global Economic Conditions Survey.
- *The State of Business Finance, Part Two: Case Studies*, brings together twelve in-depth studies of business financing seen through the eyes of ACCA members around the world.
- *The State of Business Finance, Part Three: Reflections on the Evidence*, summarises ACCA's findings and issues a call to action for governments, the financial services industry and, most of all, finance professionals around the world.



The three reports are available from the ACCA website together with ACCA's other works on access to finance.

www.accaglobal.com/businessfinance

Who are the fund-raisers?

At the global level, access to finance is an agenda highly relevant to the ACCA membership. Almost one in three ACCA members (over 50,000) are involved in raising finance for their own organisations or clients in any given year, including over 10,000 members involved in raising funds through the capital markets.

At the forefront of this effort are accountants in small and medium-sized practices (SMPs) and their colleagues working in the finance functions of small and medium-sized enterprises (SMEs). Half of the combined population of these two groups is involved in raising finance, and both are acknowledged as experts in business financing around the world.

While more senior finance professionals and managers are most likely to be consciously involved in financing efforts, much of the work required for fundraising purposes relates to the preparation of accounts and documentation. It is likely that many more junior finance professionals are involved in the process without seeing a clear link between their work and the business' financing needs. Making such links explicit can improve the way businesses evaluate and invest in their finance teams.

Even after accounting for seniority and other characteristics, ACCA's findings suggest a significant gender divide when it comes to helping businesses access finance, with female members significantly less likely to be involved in raising finance for their own businesses and even less so for clients. ACCA research has suggested this in the past, but the evidence is now much stronger. This is clearly a missed opportunity for businesses, practitioners and finance providers, and does not appear to be based on ability or behavioural patterns.

Finance is flowing again – but how well, and for how long?

As of mid-2014, financing conditions at the global level were at their most benign since the recovery began in 2009.

In most parts of the world, less than a fifth of large corporates and less than a third of all SMEs were reporting problems accessing finance.

The key factor behind this shift, however, appears to be an extraordinary level of global monetary stimulus, which is likely to prove short-lived, much like the co-ordinated monetary easing agreed by the G20 at the London summit in 2009. In any case, developed countries have benefited the most from Central Banks' largesse, whereas in parts of the world such as Africa, where significant inefficiencies remain, the recovery has made almost no difference to financing conditions.

Through the recovery, four forces have contributed to the shifting accessibility of business finance: global liquidity, the availability of collateral, region-specific risk appetite, and region-specific structural factors. ACCA's analysis suggests that risk-taking has been the leading driver of financing conditions – explaining about 46% of quarterly variance at the regional level. But liquidity and collateral are not far behind, together explaining another 44%.

It is a matter of concern that a disproportionate amount of business financing is still carried out on the basis of either security or a 'risk-free' status; neither of which is truly as secure as it seems. While this is not a market failure in the strict sense of the term, it is most certainly a failure of intermediation. It means that many finance (or more commonly, credit) providers are unable or unwilling to adequately model or price risk, that credit access is disproportionate to economic returns, and that the growing share of the business population that depends on intangible assets to generate wealth or aims for highly contingent returns will remain ill-served for some time to come.

In the banking sector, it is worrying to see that excess liquidity is to some extent a driver of innovation itself, not merely of lending volumes – with case studies highlighting how otherwise worthwhile product innovations were being triggered by the need to earn a return on growing reserves. And it isn't just banks that are herded by liquidity; venture capitalists and business angels are, to some extent, pack animals, demonstrating highly synchronised responses. They look to each other for reassurance, flock to sectors that are en vogue, and can often sit on the fence during downturns, when ACCA's evidence suggests their funding and expertise are desperately needed and would be handsomely rewarded. Finance professionals must overcome feelings of awe or deference and be willing to robustly challenge that industry if a good proposition is being overlooked. A similar level of challenge needs to be applied to the corporate sector itself, whose significant cash piles have, on some occasions, helped pick up the slack from other retreating finance providers. They could do a lot more still.

Industry inertia and regulation keep small businesses at a disadvantage

Partly as a result of the dominance of 'safe' seekers of finance, both quantitative and qualitative evidence confirm that smaller businesses must pay a premium, pledge disproportionate amounts of collateral or put in a lot of extra work to get financing.

In the case of bank loans, interest rates in the high double digits are still a fact of life in emerging markets. This very substantial variance in funding costs between emerging and developed markets is of course partly justified by objective factors, but it also reflects structural rigidities which apply equally well to large businesses. In many emerging markets, the free flow of capital is a distant dream, and many investors and financial institutions still apply country risk premia pretty indiscriminately, allowing them to over-ride real evidence of viability and growth. This fragmented financing landscape, distinguishing so harshly between big and small, 'safe' and 'risky', presents an opportunity for globally-minded organisations that can bring real local expertise to bear.

The experiences of ACCA members on both the supply and demand side of business financing suggest that some of the information that would help bridge these gaps is already available in the form of supply chain information, orders from reputable clients, management information and demonstrated management track records or expertise. It is of course up to businesses to meet finance providers half-way by ensuring a constant flow of management and financial information, but financial sectors that fail to make use of this are leaving themselves wide open to disruption.

Finance providers can convincingly argue that they do collect a great deal of information already, both for decision-making and compliance purposes, and that this, alongside new capital and liquidity requirements, skews the economics of lending against relationship-building and, indeed, against small businesses. Some of the administrative work can be automated away, but at the end of the day business financing depends on information and information is expensive to process intelligently. The finance profession can assist by streamlining and improving the quality of information provided by businesses, and governments can assist some of the smallest businesses by subsidising the production of such information.

A new breed of professionals is on the rise

While businesses could do with providing more and better information, the evidence from member interviews clearly shows that it takes a true business partner to meet finance providers half-way.

The finance profession has built a solid reputation as advisers and intermediaries, but the frontier that really needs to be crossed is that of working with operations and the supply chain to demonstrate to finance providers how finance is used and how it generates returns. With one in four fundraising members involved in supply chain finance of some kind, the ACCA membership is clearly tackling this challenge head-on, but accountants with a strong understanding of operations will have an advantage in this regard.

On the practitioners' side, it is clear from ACCA's case studies that accountants involved in business financing are required to provide a proto-assurance service; this appears to go beyond ensuring the information provided is in the right format and error-free, and actually involves a sanity-check which both applicants and finance providers appreciate. Practitioners bundle this proto-assurance service into other, paid-for offerings, but it is still a distinct service with its own distinct cost and value to clients. And while this quasi-assurance offering is clearly valued, it was disappointing to see that finance providers can, in some instances, treat a full audit as only marginally more valuable.

Into a brave new world, timidly

Businesses and finance professionals seeking finance are faced with a dilemma.

On the one hand, they need to do more to engage with an ever-widening range of financing tools. Innovation is rife in the financial services industry and yet the majority of funding applications facilitated by ACCA members still relate to bank loans – anecdotal evidence suggests the advantage of familiarity is still very powerful. Despite attracting an enormous amount of venture capital and capital market funding, alternative finance platforms have yet to make inroads within the profession, at least outside a few early adopter markets in the West. There is, however a lot of precedent for alternative paradigms taking hold in business financing, then giving birth to new innovation. For example, the dynamism of the Middle Eastern economies during the past two years has given a boost to financial innovation, with sharia-compliant solutions filling important niches in the region's financing landscape.

Regardless of origins, innovative alternative finance providers appear to approach their service offering through an interesting process of reduction: distilling traditional financing products into the underlying asset classes. Banks' appetite for SME loans, for instance, may prove to be only a very small share of the full investor appetite for SME credit, and likewise early-stage equity should prove to be much more popular than individual start-ups. It is likely that future studies of business' access to finance will increasingly focus not on the type of financing sought by business, but the particular asset classes they are producing for investors, their returns and the risks involved; this type of data will in turn help attract investors to segments of the market that are currently under-served.

Even for the professionals, however, a broader range of financing options needs to also be coupled with greater access to advice and guidance to restore focus. Both the quantitative research findings and case studies included in this report warn against the risk of over-stretching when looking for finance; the pursuit of funding requires constant input at the top level of the organisation and the cost of familiarisation, search and distraction is quite severe. In this context, calls for increasing business' awareness of alternatives, while still welcome, are incomplete.[1]

1. It is worth noting that more established asset classes, such as sovereign bonds, are already treated in this fashion, with analysts discussing 'demand' in terms of investors' demand for the asset as opposed to the issuer's demand for finance. See for instance P.O. Gourinchas and O.Jeanne, *Global Safe Assets*, Bank for International Settlements Working Paper No 399, <http://www.bis.org/publ/work399.pdf>, 2012.

Salvaging the financing relationship

Enterprises with fewer than 50 employees around the world remain disadvantaged when it comes to the ability to raise finance, with ACCA members in such organisations recording significantly lower levels of dissatisfaction with the financing process, even after accounting for other factors.

Case studies confirm the widespread perception that financing conditions remain very challenging for small businesses around the world, and even now many new financing propositions are not targeted at them.

The call for a different approach to decision-making in the banking sector can be heard loud and clear through almost all case studies reviewed in this report. Devolving more discretion to bank managers with their ear on the ground is a frequent proposal from businesses and their advisers, who both regret the banks' slow move away from relationship banking towards a more centralised decisionmaking model. It's worth wondering, however, if a dedicated manager with final say over lending decisions is really what businesses want most.

Dig deeper and a different narrative emerges. It is the timing and conduct of financing decisions that is crucially important to businesses seeking finance, and yet there is little evidence of established finance providers factoring this into their processes. In one case examined in this report, a major bank keen to hold on to customers had a clear incentive to postpone decisions rather than bow to the inevitable and just say no. Such non-standard cases can take between three to six months to resolve, during which time the business seeking funding can suffer substantial levels of disruption. Some of the members interviewed address this financing relationship risk by making contingency plan upon contingency plan, at the risk of overstretching themselves and the business.

While banks at least have the option of choosing more transactional business models, with other types of financing relationships are inevitable and the issue of trust is paramount. At least two of the members interviewed for this review made it clear that businesses unable to assess the commitment or ulterior motives of finance providers can be paralyzed or thrown into a tailspin of endless pitching. Two others spoke on the condition of anonymity due to the extremely sensitive nature of their business plans, or their experiences. As trusted intermediaries, accountancy practitioners can function as a crucial link in the fragile chain of trust that underpins all business financing.

Both finance professionals and finance providers should note how strongly the sense of ownership and control influences the experience of raising finance. Senior professionals with final say on decisions tend to give a more positive view of financing than their more junior colleagues, or those with no final say on outcomes, while board members need to be eased into financing decisions through an enhanced business planning process. Restoring finance relationships, it seems, is about restoring trust, ownership and control where they belong.

A role for governments

Both the quantitative and qualitative evidence presented in this study suggest a significant direct and indirect role for governments and central banks in financing business.

At the macro level, it is clear that the co-ordinated financing push of the London G-20 meeting in 2009 did help unlock a great deal of trade finance internationally; liquidity programmes such as the UK's Funding for Lending made a difference; and major monetary policy decisions such as the Federal Reserve's 'tapering' of its asset purchase programme, or China's crackdown on shadow banking, have had a substantial effect on the ground.

More direct influence by governments is also observable in our evidence. Individual governments expected to pursue expansionary fiscal policy tend to preside over more active banking sectors, suggesting a great deal of government input into supposedly commercial banking globally. Elsewhere, governments can exert 'soft power', which may not trigger immediate increases in lending but does tend to eventually cascade down to individual bank managers. Government initiatives can subsidise business planning, due diligence, or assurance. A lot of work remains to be done at this level, but if careful interventions targeted at these three areas can shift the economics of business financing in favour of smaller businesses, the benefits for the global economy will be enormous.

Where the buck stops

It is an easy mistake to overlook the role of boards and governance in business' access to finance.

Many of the world's most promising businesses are family-owned companies or closely-held groups whose opacity can hurt borrowing prospects while also biasing them against equity issuance. Directors need to be kept abreast of short- and long-term financing needs and furnished with scenario-based analysis to help them understand the long-term implications of their decisions.

Meanwhile, with so much business lending effectively underwritten by directors through guarantees and personal sureties, even financing decisions not involving a loss of control to third parties are of intense interest at the board level and the very premise of external borrowing is easily questioned. Loans from directors, their families and friends, are a popular alternative means of financing businesses, but can create controversy and problems for follow-on funding rounds. As a result, practitioners are substantially involved in what would appear to be non-commercial and relatively informal arrangements. Our qualitative evidence shows that it might be easier for the finance professional, as a relative outsider, to introduce funding propositions with implications for governance and the board, where an insider might face steep opposition.

An uncertain future

Mid-2014 was a portentous time for business financing.

A substantial easing of global financing conditions came to an end just as financial intermediation was set to be decisively disrupted by a host of innovative transaction and financing platforms collectively referred to as Fintech. It is likely that access to finance will deteriorate for most businesses in the short term, while the ability to finance working capital in particular should improve significantly in the medium term. To make a difference to the long-term financing of businesses, however, a new level of innovation is needed in how businesses are run, not the mechanisms through which they are funded; one in which the accountancy profession can play a decisive role. ACCA believes that businesses need reasonably priced and quick finance, but more importantly they need good planning, trust, and finance appropriate to their purposes and circumstances. With appropriate guidance and partnerships, today's complete finance professionals can help deliver this.

A call to action

ACCA's first global review of access to finance highlights a number of priorities for policymakers, regulators and financial institutions.

- Policymakers need to acknowledge that today's improved financing environment is exceptional and could prove short-lived.

- Going forward, policies to support business financing should account more explicitly for the multiple macro-factors influencing access to finance over the business cycle, including global liquidity, risk appetite, structural deficiencies and eligible collateral values.

- A concerted effort between international financial institutions, regulators and standard setters is needed to overcome the fragmentation of the global market for business finance.

- Financial institutions and regulators need to re-examine the over-reliance of business financing on collateral, but also look into ways of diversifying the kinds of assets accepted as collateral.

- Relationships between small businesses and financial institutions globally are fragile; they can only be strengthened by restoring trust, ownership and control, and finance professionals are ideally placed to lead this agenda.

- Policymakers and accountancy practitioners need to challenge venture capitalists and corporates eyeing potential investments to see beyond sector fads and work with business advisors to unearth opportunities wherever they may be.

The review also suggests a substantial agenda more specific to the accountancy profession.

- A new breed of finance professionals is needed to unlock the next level of innovation in business financing. Finance professionals need to be able to act as business partners and work seamlessly with operations and the supply chain in order to support innovative business financing.

- The profession needs to step up its engagement with the growing range of alternative financing platforms, including peer-to-peer lending and crowdfunding.

- In working to improve awareness of financing options, policymakers and the accountancy profession need to realise that businesses may not benefit from an endlessly wide range of options. The value of professional advice will often be in narrowing this range down to a few realistic and efficient options.

- The accountancy profession's ongoing debate regarding the value and future of assurance needs to more directly address the elements of assurance involved in small business financing advice. There is a risk that innovative financing arrangements and platforms will create a need for assurance without a credible mechanism for paying for it.

- A substantial gender imbalance exists in business financing activities that serves neither financial institutions and investors nor business well. Employers need to understand how this imbalance emerges and how it can be remedied.

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