Bank Funding – October 2021 - One Man's View

Here is a view of the current market from a commercial manager at Kiwibank.

What we are really talking about, is bank funding for business purchases. And by extension bank funding for business growth. In my mind the key words here are 'bank funding'. To be quite distinct from 'bank investment'

There is many factors involved of course. 4 key points

1. In my view the basic requirements and bank standards have NOT changed at all discernibly, from 26 years ago, when I borrowed to buy my first business.
2. The market (or should I say misguided regulatory requirements forced on banks as government policy – and by extension NZ business owners) has absolutely changed and continues to change more rapidly
3. Then we have the influence of technology, which is most considerable in last 10-15 years.
4. More recently there is obviously Covid and related uncertainties.

In general I would say that a perception that banks no longer lend on (unsecured) business or do cashflow lending is an obscured view, caused by a filter of compliance, technology and market/covid change. NOT bank change.

Of course it's human nature to WANT banks to lend, based on what you want – which in turn means that should there be resistance from the bank to lend, it becomes easy to blame 'the bank' as the common denominator over time. All the while overlooking the very real, but largely faceless, myriad factors that have slowly crept in to change the lending environment, in which you want to borrow.

My view – and please bear in mind I still own a small business and have been both a bank business borrower and bank business lender – is that I DON'T WANT THE BANK TO CHANGE in any way, (other than some customer service and customer experience metrics!). I want banks to remain something like an immovable bedrock to the financial system for NZ. Something certain, solid and known, against which the market can calibrate itself, to take its own risk. Or put another way, its valuable protection for NZ business that banks bank, and don't invest.

Entrepreneurs invest, business owners invest, investors invest, governments can invest. Banks bank.

In very recent times there has absolutely been delays to loans, simply because of Increased demand, lack of capacity to cope and lack of capability to assess under increased workloads and more complex/uncertainty. A perfect storm for sure – but largely a red herring in my view. Moreover Kiwibank do enjoy and protect an ability to be a bit outspoken about Small and Medium business lending – because beyond home lending, that is our only real market. We simply don't get confused about agri or corporate or etc as we don't do it at all. Our mandate from shareholders being the Government, ACC and NZ Super Fund is about the health of the long term NZ economy, not next years shareholder return.

If you think about that in a simple business investment way – if you are ACC/Super/Government and collecting revenue from basically EVERY business in NZ – would you more prefer an immediate return from your investment in Kiwibank…….or an ongoing return from every business in NZ regardless of who they bank with, including Kiwibank, that results from a healthy and vibrant NZ economy? Seems like as simple answer to me.

So to push further on how to get business lending from a bank, its worth pushing further with the difference between banking and investing. That includes differentiating between unsecured lending and cashflow lending. The two should not be confused.

- A bank lends money for a fee, plus interest at x%.
- Broadly, we borrow the same amount and 'make profit' on the difference in the rate you pay, vs what we pay.
- You only ever owe us what you borrowed, plus the interest.
- Our income is fixed. It does not go up or down really.
- That's banking.

You buy an opportunity off us, to have a crack at what you want to do, in <u>your</u> business.

- If your business goes poorly, you still owe us the same amount of money.
- If your business goes OK, you still owe us the same amount of money.
- If your business goes exceptionally well and you make billions, you still owe us the same amount of money.
- That's investing and owning business.

<u>You get to take BOTH the upside and the downside.</u>

We take neither.
We are that immovable bedrock foundation of certainty, against which you can make your own investment decisions.
Which is why its important to point out the difference between unsecured lending and cashflow lending.

Banks happily cashflow lend, to businesses with <u>proven & existing</u>, income, steady incomes that can sustain payments of loans, even in the face of reduced incomes or increased costs. Basically you have to prove <u>you already have</u> the capacity to pay it back.

Cashflow lending is not provided to a business that doesn't currently have the income to pay the requested loan - <u>that's unsecured lending</u> and gets closer to 'investing' – which is your job as discussed above.

This distinction should provide some insight as to why smaller business are supposedly not getting 'cashflow' loans – often its simply because there isn't sufficient proven, existing and steady cashflow within the business - and what is actually being requested is an unsecured loan - one step closer to 'investment', which banks don't/shouldn't do.

In my experience another very common scenario is owners not wanting to provide security, even though they have it. "We want the business to borrow, based on the business value and don't want to risk the house". Putting aside the question personal responsibility of the business owner for a second, the bald facts is that (as a bank) I have to apply tougher and more rigorous set of criteria for that scenario, than using the security, to be sure there is capacity of the business to pay the lending over a shorter term.

When the offer of BOTH options is made (as it often is) usually the secured option is adopted by the business owner, as being cheaper and easier. Their choice, sometimes mis-construed as 'not available'? Especially when you consider the fact that they still owe the money to the bank regardless, because we are not investors, we are bankers.

- Ultimately I wonder if there is an over-emphasis on the role business owners want the bank to play?
- Its your business and you want to own your own business….so its important to own the responsibility for your business too.
- Banks can sometimes help, we can't and shouldn't do it for you, even though you might want us too……

I like the 5C's from last month's market update – a good example that banking hasn't actually changed. However, I would change the order

1. **Character – personal factor, credit history, experience**
2. Capacity – ability to repay loans (cashflow)
3. Capital – Equity – skin in the game – a cushion for tough times
4. Conditions – appropriate structuring and lending controls
5. Collateral – the lenders secondary source of repayment if the first source (cashflow) fails.

We will never lend to someone we don't trust, like or isn't prepared to take responsibility in full for their own business. That's why its called owning your own business.
Collateral is last resort. If either of us ever get to point 5, we've both failed anyway.

Richard Lemon
Commercial Manager – SME MVP Project

M 0274 893 252
Kiwibank, 668 Colombo street, Central Christchurch 8011
(Corner of Lichfield & Colombo Street)
PO Box 1244, Christchurch
www.kiwibank.co.nz