The Second Round Table of Bankers and SMEs

Final Report

CONTENTS

INTRODUCTION

Bank and company both have the same intention: the optimal functioning of their own business. In order to achieve this, they need each other. Moreover, they both benefit from each other's financial strength. But this is usually all they have in common. Their insight, methods and means all differ, as well as the expectations they have of each other, especially if the entrepreneur belongs to the category of Small and Medium-sized Enterprises (SMEs). Instead of the harmonious co-operation which both parties desire, the reality is often friction resulting from each other's attitude and behaviour.

In recent years the European Commission has actively addressed this issue. In its Communication of 10 November 1993[1], the Commission concluded that many SMEs are, more than ever, dependent on banks for finance, but that banks are acting very cautiously when dealing with SME clients. The Commission considers this situation to be a matter of concern because the competitiveness of SMEs could be seriously compromised as a result. Moreover, in the present economic climate, the job creation capacity of SMEs is crucial and the Commission has pursued a number of policies designed to improve this.

As a first step towards dealing with the problem, the Commission initiated the Round Table of Leading Representatives from the Banking Sector. The members were given the task of identifying the main issues concerning the relationship between SMEs and banks. Their report, published in May 1994[2], concluded that the SME sector does not function optimally because of:

- a lack of sufficient own capital to finance the enterprise effectively
- a lack of sufficient cash due to late payment by debtors
- insufficient access to credit on reasonable terms
- inadequate knowledge, experience and capacity to ensure good financial management

The authors of the report highlight the problems resulting from the tension which exists between banks and SMEs. The SME sector thinks, according to the report, that banks charge too much for credit, require too much security, provide insufficient long term finance and are reluctant to grant credit in relatively small amounts. On the other hand, banks think that in the financing of SMEs they are confronted with risks which are too high and with administrative, processing and monitoring costs which are excessive. Besides, from the banks' point of view, the SME sector does not provide enough attractive investment proposals and suffers from a lack of transparency.

Thus the implication of the report from the first Round Table is that banks and SMEs are in a stalemate. To escape from this impasse, there are a lot of recommendations which would contribute to a more effective partnership between banks and SMEs. To help ensure that these recommendations were implemented, the authors of the report proposed that there be a second stage of consultation. This suggestion was taken up by the Commission which set up the second Round Table, the Round Table of Bankers and SMEs, in October 1995.

The second Round Table is different from its predecessor in a number of ways. Firstly, as regards its composition, one bank from each EU Member State and more European SME organisations have participated. The members also have a wider range of backgrounds **(Annexe 3)**.

Secondly, the working method is different. The discussions in the second Round Table have been based on interviews with key experts in the SME market, substantial desk research, fieldwork from participating organisations and the output of a range of expert meetings, which not only covered the area

[1] Commission Communication on the financing problems experienced by SMEs, COM(93) 528 final of 10 November 1993
[2] Commission Communication on the Round Table of Leading Representatives from the Banking Sector, COM(94) 435 final of 28 October 1994

of credit provision but also other services in the banking/SME sector[3]. The co-ordination of this information-gathering was carried out by an independent organisation, the Stichting Toekomst Middelgrote en Kleine Organisaties (STMKO) [Foundation for the Future of SMEs] in Eindhoven, The Netherlands, which oversaw the preparation of the report.

A third important difference was the objective of the second Round Table. Apart from going further into the problems in the relationship between banks and SME entrepreneurs, the second Round Table focused on furnishing solutions based on examples of good practice throughout Europe. Some of these examples are outlined in greater detail in case studies **(Annexe 1)**.

Besides differences, there were also many areas of agreement, of which the ultimate goal, realisation of a genuine partnership between bank and SME, was the most important. The second Round Table highlighted a problem in this respect, namely, that a partnership requires the input of every concerned member, in his own interest and in the interest of others.

Experience shows that situations in which the business and the bank have only little and superficial contact generate misunderstandings and conflicts, leading to positions which undermine the necessary strengthening of the relationship. Since, under these circumstances, a partnership cannot be achieved on the basis of one-to-one contact (i.e. an exclusive relationship between bank and client), this has to be generated in another way. The examples provided show that an improvement of the relationship is also possible by steering a middle course at the beginning of a partnership between banks and the professional organisations representing SMEs. The concrete actions which result from such a partnership benefit SMEs as well as banks.

This report examines the practical actions which were taken to strengthen the relationship between bank and SME entrepreneur. These concentrate on situations in which the partnership comes under pressure or cannot be achieved, for example in cases of a request for credit, price arrangements, maintenance of mutual contacts, serviceability and behaviour in problem situations and with risky SME categories. Examples of practice are cited from all the European Member States.

[3] F. van der Staak, University of Technology Eindhoven, De Tweede Ronde Tafel van Bankiers en MKB (The Second Round Table of Bankers and SMEs, June 1996, Eindhoven, The Netherlands)

Actions for improvement:
A guide to better practices

1. The framework of the Second Round Table: findings of the initial research

1.1 INTERVIEWS

What is the relationship like between banks and SMEs in Europe? In order to arrive at an answer, studies have been conducted, outside the framework of the expert meetings of the Round Table, among SME representative organisations at national level, accountants and participating banks. 50 SME organisations were contacted by post. Unfortunately only 10 organisations in 8 Member States responded: there was no response from Denmark, Ireland, Germany, Belgium, Luxembourg, France and Portugal. Research among the banks, in all 15 Member States, took the form of personal interviews with managers responsible for SME policy at local and national level. The interviews with accountants were mainly conducted with affiliates of Moores Rowland, a medium-sized international accountancy group with a strong focus on SMEs.

All the banks interviewed were of the opinion that their relationship with SME clients was quite good, although considerable efforts were made to achieve improvements in areas where problems were deemed to exist. The main problem, in their view, is how to conduct an effective and efficient relationship management policy.

The SME representatives who participated in the research are a little more sceptical about the state of the relationship. They believe that the tariffs charged by banks are too high, especially for credit. Moreover, 9 out of 10 pointed to substantial differences in price for large companies on the one hand and SMEs on the other, SMEs paying interest rates between 1.5 and 3 percentage points higher. Other important criticisms levelled against banks are: an excessively risk-averse approach, unreasonably high collateral requirements, lack of risk capital, insufficient transparency and, above all, inconsistent behaviour. The latter manifested itself most obviously during recessions, when SMEs who owed money would be subject to tighter lending conditions and some sectors, such as start-ups, would be particularly squeezed. When asked to score the bank-SME relationship on a scale of 1 to 5, 7 out of 9 organisations gave a mark of 3 - in other words, room for improvement. However, they admit that it is not only the banks who are to blame for this situation - SMEs could help to improve matters if they were willing to be more open and if they were to become more competent in basic financial management and business skills.

The 15 accountants surveyed (one in each Member State) partly endorsed the criticisms raised by the SME organisations. They agree that banks concentrate too much on risks, paying too little attention to the qualities of the entrepreneur and the future prospects of the company. This results in the banks asking for too much collateral and, in some countries, failing to supply enough long term financing. The accountants also accuse banks of being inconsistent in their behaviour and of remaining too detached from their clients. They believe that banks see relationship management too much in terms of selling products and do not demonstrate a real commitment to helping the entrepreneur cope with the ups and downs of his business. However, the accountants identified differences between the situation in urban and rural areas. In the latter, bank officers tended to be more closely involved with their clients, although they possessed a lower level of skills and know-how than their urban counterparts. Overall, the accountants regarded banks' activities to support SMEs more as a means to serve their own interests, for example by generating good public relations, than as a genuine expression of solidarity with this client group. This tended to be borne out when trading conditions were tougher, at which time less (or no) money would be spent on support activities such as publishing information brochures or organising seminars.

This scenario was challenged during the expert meetings in order to establish whether it is correct or not. And, if so, to find out what the parties involved are doing to solve the problems which exist, thereby both improving and intensifying the relationship between banks and SMEs.

1.2 DESK RESEARCH ON GENERAL SME POLICY IN BANKING

From the 1980's until now, the emphasis of mainstream banks was strongly on cost-cutting, for the following reasons:

- **Economic recessions** in the last two decades hit banks very heavily, resulting in a sharp decrease in profits and, in some years, losses or even failure;
- **Deregulation and privatisation** of national banks as a consequence of the Single Market and EMU, resulting in less protection by governments and fewer subsidies in case of losses;
- Appearance of **new competitors** in the financial market, resulting in pressure to reduce tariffs on loans, to increase tariffs on savings and the introduction of new, more effective and efficient distribution channels;
- An increasingly **calculating approach by clients**, especially at the upper end, resulting in direct access by clients to the capital market (some clients have better ratings than the banks themselves), in-house banking (leaving only the loss-making services to the traditional banks) and even the evolution of some in-house banks into commercial banks (i.e. Migros, Marks & Spencer), exploiting existing relations with clients and suppliers;
- Overcapacity due to proliferation of banks' services in general and to outdated structures in particular banks.

The main ways banks try to achieve cost-savings (sometimes combined with growth in turnover) are:

- mergers and acquisitions in order to create greater economies of scale;
- passing on banking costs which used to be free or subsidised;
- looking for new distribution channels and transferring lower end clients to the cheaper distribution channels;
- optimal use of new information technologies as instruments to further rationalise the handling process, make a better judgement of risks, improve the quality of products and act as a new distribution channel (virtual banking);
- reducing the number of employees working in the bank (at all levels);
- cocooning risks, i.e. looking at appropriate securities other than traditional collateral by also taking into consideration the qualities of the entrepreneur and by making use of new technologies and databases in order to arrive at a proper estimation of the remaining risks;
- developing new products with a higher added value and fewer competitors, especially tailor-made products in niche markets;
- looking for new target groups such as fast-growing and innovative small firms;
- better use of sales capacity by cross-selling (often the main focus of account managers);
- rationalisation of the branch network (closure of smaller offices);
- focusing on high value clients by benchmarking;
- drifting away from the traditional SME market to other more profitable markets, such as international clients;
- less consideration and care when problems arise between bank and client.

This policy has not been a complete success and has a number of negative consequences for the mainstream banks:

- The traditional SME client often feels left out in the cold by banks, resulting in:
  - less loyalty to their bank, less information about the situation in the company and more inclination to move to other banks with promotional tariffs;
  - switching over to using the same economising language as banks, even if this is not correct: for example, claiming that banks are too expensive (even when statistics show that the tariffs charged by banks have decreased in real terms or sometimes even been removed altogether, e.g. Bank of Ireland);
  - a call for even more rationalisation by banks, such as stopping cross-subsidies, even when these are benefiting weaker SME colleagues like start-ups;
  - a general feeling by clients of being more patronised than before due to all the new demands for informa-

tion by the bank, in addition to the usual requirement for collateral;
- holding banks liable for incorrect advice or even inappropriate financing;

- Developing new products and new target groups also means higher costs (especially in the short and medium term): specialised services and products have small markets and attracting new target groups means high marketing costs. In addition, banks with specialist products are also faced with:

  - mistrust of banks' motivation in offering such products, as well as of the real benefits (i.e. venture and seed capital, where entrepreneurs fear losing control of their company);
  - reproaches about the quality of account managers as regards their knowledge of the needs of the new target groups and of the specialist products offered by their bank;

- New smaller and regional banks raise their profile in the SME market in other ways: they concentrate less on offering lower tariffs or a wider range of products and more on giving their clients a feeling of concern and loyalty, thus stressing that, for them (and in contrast to other banks), the client is a real partner;

- There is strong pressure from outside groups to do more for SMEs, since SMEs are an important source of new jobs.

Banks are now more than ever aware of these problems and are formulating new responses to these dilemmas but based on their own particular strengths:

- tackling the most criticised aspect of SME banking - financing - by:

  - offering better access to the present financial products, with or without the support of third parties;
  - offering SMEs better loan conditions, again with or without the support of third parties;
  - developing new products and / or new services for remaining gaps in the market for credit;

- intensifying the relationship and improving communication between bank and client by:

  - increasing transparency of banks' behaviour and rewarding good conduct by clients;
  - improving the quality of products or services by listening to and involving clients more;
  - creating greater affinity with clients by redefining the authority of SME account managers, improving their skills and knowledge through intensive training and encouraging them to take a proactive approach;

- taking responsibility for improving the quality and number of SME entrepreneurs for both economic and wider social reasons by supporting awareness of entrepreneurship in society in general, start-ups in particular and existing companies in need of help;

- adapting banking structures to the needs and wishes of SME clients and shortening the distance between clients and decision-makers within the bank by restructuring office networks and process work flows (separating front and back office), offering more and better integrated ways of communicating with banks (multi-channel distribution) and entering new partnerships with other suppliers of services to SMEs in order to improve and intensify banking services.

2. Improving SME financing

SME entrepreneurs have several sources of financing at their disposal, such as retained business profits, their own personal savings, loans and gifts from family and friends, supplier credit, etc. The most important source, however, is bank loans. Many kinds of financial products are offered by banks. The most frequently used are overdrafts and term loans, followed (at some distance) by leasing and factoring. The share of any of these products in the total banking supply is quite stable in all Member States and a drastic change in the situation is not expected in the foreseeable future. In so far as some shifts will occur, these will be mainly in the Southern countries, where banks will have to concentrate on promoting corporate finance and new enterprise services, rather than their interest margin.

When granting credit, the relationship between banks and SMEs is different from the usual one between suppliers and customers. Each party's interests, and hence their attitude towards each other, are different in many ways. What do they expect from each other? And what makes their relationship so special? A discussion of this question is followed by an examination of the importance and position SMEs occupy within banks and into the way SME financing is handled. Finally, a variety of initiatives to overcome the problems in the financing relationship between banks and SMEs are outlined.

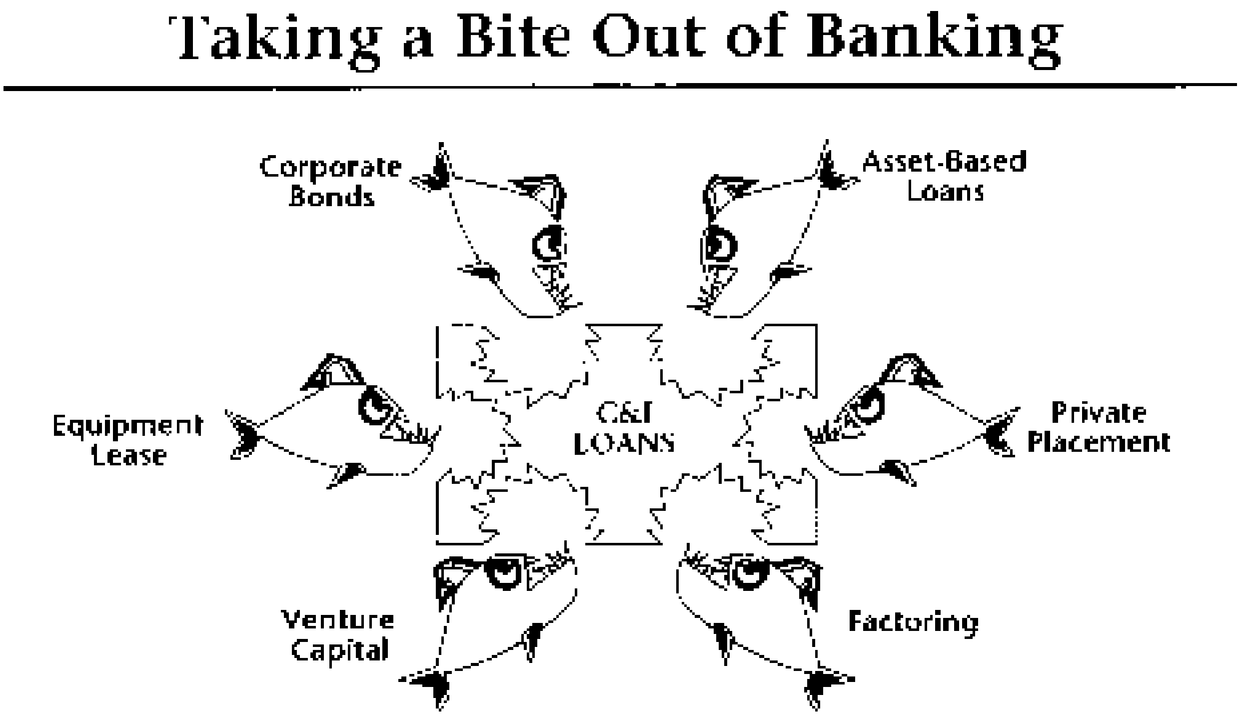
2.1 THE DIFFERING INTERESTS

Of course, SME entrepreneurs want to obtain their financing at the lowest possible price. The costs charged by the bank have two components: Firstly, the transaction costs for the various actions, usually recovered via a fixed commission when the loan contract is signed. Secondly, the interest costs. The interest rate level is determined by various factors and is sometimes - albeit to a limited extent - subject to negotiation. This prompts a second demand from SMEs: transparency. Many entrepreneurs regard the structure of the costs for the various forms of financing as rather untransparent. The range of interest rates and pay back conditions is too wide, making it difficult for the average entrepreneur to make an accurate comparison of the different options. A third concern of SMEs is obtaining a sufficient amount of lending. Sometimes SMEs ask for less than needed for fear of refusal, sometimes they ask for more than required in order to avoid possible shortfalls later on. Both can lead to financial difficulties if banks do not intervene. Finally, SME entrepreneurs try to achieve their financing with as few guarantees as possible, especially those of a personal nature. As far as possible, they want to be financed on the basis of their business plan.

Banks' interests are somewhat different. Even though some banks are non-profit-making (and receive tax concessions in return), they still have the same basic considerations and apply the same fundamental rules when making lending decisions. Firstly, they incur the real risk that the enterprise cannot meet the pay-back and interest obligations. In general, banks may not and will not take on risks originating from the business activities of the entrepreneur. The banks' interest is therefore to manage their potential risks as tightly as possible. They try to do this by demanding enough security and gathering as much information as possible about the enterprise, the sector and the entrepreneur. Because of this, banks tend to reduce the high financing requests of many enterprises, since over-generous financing can put too much pressure on the enterprise's capacity to pay back the loan. In some Member States, banks even limit themselves to granting at most 20 to 30 percent of the required capital.

This seems to be in contradiction with another goal, namely maximising their sales. Banks are institutions that have to make profits. In practice this means selling other products apart from loans, such as deposits, investments, insurance, mortgages, private accounts etc. Finally, banks try to improve their profit margins by minimising costs. Due to increasing competition, the intermediation margins are now under pressure in the SME market segment as well. They try to achieve cost-savings mainly by serving the market as efficiently as possible, among other things by using more distribution channels and by good portfolio management. This need to reduce costs can, however, conflict with the entrepreneur's need for certain services from the bank.

Diagram 1: Shrinking Market for Traditional Banking Products



2.2 DEFINING THE SME MARKET SEGMENT

For almost all banks, SMEs are becoming the most important groups of clients for traditional business financing. A number of reasons for this can be highlighted. First, many banks have recognised that innovations in the field of financing have led to a shrinking market for traditional products (see diagram 1). Interest on loans as a source of income to banks is reducing in importance (see diagram 2). Larger companies in particular are making use of alternative sources of financing, while SMEs still (have to) rely primarily on bank loans. Moreover, an increasing number of banks have come to the conclusion that a solid SME policy can result in a considerable increase in profits. A number of banks also have historically strong connections with SMEs. This is especially true of the co-operative banks, the savings banks and other banks that have been founded by SMEs themselves. The SME sector often has one or more seats on the board of these banks. Finally, trade and industry is dominated by SMEs in many countries, especially by micro-businesses. Put another way, there is no alternative for some banks who are active in the national corporate market.

But how exactly do banks define small and medium-sized enterprises? The definition varies considerably among banks, a result of the need for certain securities, profit requirements and a desire to offer optimal support to the business client. However, the recent Recommendation concerning the definition of SMEs, adopted by the European Commission on 3 April 1996[4], now provides a clear definition of small and medium-sized enterprises.

Although it is only a Recommendation, the Member States are likely to implement it, since they are already obliged to

[4] Published in OJ L 107 of 30 April 1996, p. 4.

respect the Community Framework on State Aids which uses the criteria of the new definition to define SMEs. As far as Community programmes are concerned, these will adopt the definition before the end of 1997 for all measures in favour of SMEs. Thus the Recommendation not only reinforces both the consistency and visibility of SME policy, it also gives banks a useful yardstick when they come to devise their own SME definition.

2.2.1 The profit requirements

Some banks use definitions designed to contribute to obtaining an optimal profit. They focus especially on turnover. This is based on the premise that the potential number of banking services bought by an enterprise increases in proportion to its turnover. This need not be the total turnover of the enterprise, but may be limited to that on the current account with the bank. As a result, banks not only use a flexible upper limit when defining SMEs, but also a certain lower limit. Small and medium-sized enterprises with a low turnover are not included among the target group, usually being served from the private customer department. For banks where this strategy is applied, SME policy in respect of employment and turnover is usually similar to that for medium-sized enterprises.

Diagram 2: Non-Interest income is an increasing share of banks' overall income

	1983	1993
England	35%	45%
The Netherlands	24%	33%
Germany	17%	24%
France	16% (1988)	40%
Belgium	16%	33%

Source: OECD, 1995

2.2.2 Service to the client

All the banks questioned claim that their definition is also dictated by their desire to offer optimal support to SME clients. The degree to which local offices, with their special knowledge of local circumstances, can be exploited is decisive in this matter. Enterprises that cannot be served optimally at local level anymore are labelled 'large' and hence dealt with at district or head office level. The danger of this approach, however, is that large differences in quality can arise between the services provided at the various levels, because of which smaller enterprises may get lower quality service and larger enterprises in remote areas cannot have their banking requirements fully met at local level alone.

Although SMEs are looked at differently by the various banks, the definitions used have one thing in common: they are not all-embracing descriptions, but indicators of the target group. With the aid of various guarantee, profit and support criteria, the desired target groups/segments are delineated within the total SME spectrum now encompassed by the Commission definition mentioned above. This then allows SME policy and the available instruments to be targeted on those specific market segments.

2.3 THE FINANCING PROCESS

Due to the risks with which they are confronted, banks have to make well-considered financing decisions. This means that the possible risks have to be estimated and controlled as effectively as possible. How do banks do this for SMEs? In other words, what sort of procedures are involved in a request for credit?

Almost all participating banks use formal screening procedures, including risk classification systems. Only a few local, independent banks do not use them. In these cases, the financing/credit requests are judged entirely on the basis of personal experience and evaluation. Apart from some small differences, the screening procedures of the various banks are similar. In general, the bank analyses and judges a credit request from an SME enterprise on the basis of the nature and size of the request, the type of enterprise and sector in which it operates, the contents of the business plan, the (observed) qualities of the entrepreneur, the cash-management history of the business, the financial data provided and, finally, the security which is offered.

Numerous questions are considered when assessing a credit request, such as: How high is the required amount? What is the money needed for? What kind of financing is being requested and is this really the best solution for the client? Is there a substantial business plan that has been approved by a competent, external expert, such as an accountant or business advisor? Who and what is the entrepreneur and what are his or her priorities? This last aspect cannot be analysed objectively and exhaustively enough. It is a question of feeling that can, however, ultimately be conclusive.

Financial annual returns form a large part of the input of the screening procedures of banks. The risk classification systems lean strongly on these figures. These systems summarise the main figures from the balance sheet and profit & loss account of the enterprise, which give an indication of its profitability, solvency and hence pay-back capacity. Based on the most recent data, every client is assigned a score. Completion of the risk classification system is done by individual banks and ranges from three- to seven-point credit grading systems, depending on the specific needs of the bank concerned. This "grade", among other things, determines whether or not the request for credit will be granted.

To limit the risk of default, it is usual that entrepreneurs have to provide the bank with a certain amount of security which covers the amount of the loan. This collateral is usually a key element in the decision procedure to grant credit. The most important types of collateral are financial assets, both movable and immovable, and guarantees. If the creditor is unable to meet his repayment obligations, the bank must have substantial security at its disposal. Successful completion of this procedure can eventually lead to a credit proposal which, in turn, has to be approved by one or more persons from the bank, depending on the size of the credit request. A lack of collateral, absence of track records or incomplete financial data are just a few examples of problems with which banks are confronted. There are, however, a number of third parties that are able and willing to help enterprises to provide securities to banks, namely authorities, institutions and even other enterprises.

Guarantees, either total or partial, covering the reimbursement of the loan which has been granted, are available from public and private bodies. Additional capital can be offered directly via government loans and participation in share capital, or indirectly by means of subsidies and fiscal regulations. In the case of guarantees, the government gives a total or partial guarantee covering the reimbursement of the loan which has been granted. Of all these methods of government support, the fiscal regulations and, in some countries, the guarantees seem to be the most effective.

2.4 CHALLENGES TO BANKS

Financing constantly presents banks with new challenges. That certainly holds true for the financing of SMEs, who are looking for banking products which are better adapted to their needs (thus reducing their need for external capital), less collateral and lower costs. Banks, however, have their own set of priorities due to the fact that, for many of them, granting loans to SMEs is a low profit or even loss-making activity. This is partly because of the relatively high transaction costs and partly the high level of (unexpected) losses. Research from the Loan Pricing Corporation gives some insight into this area (see diagram 3). In recent years, banks have worked hard to find solutions to this unsatisfactory situation.

2.4.1 Improving efficiency

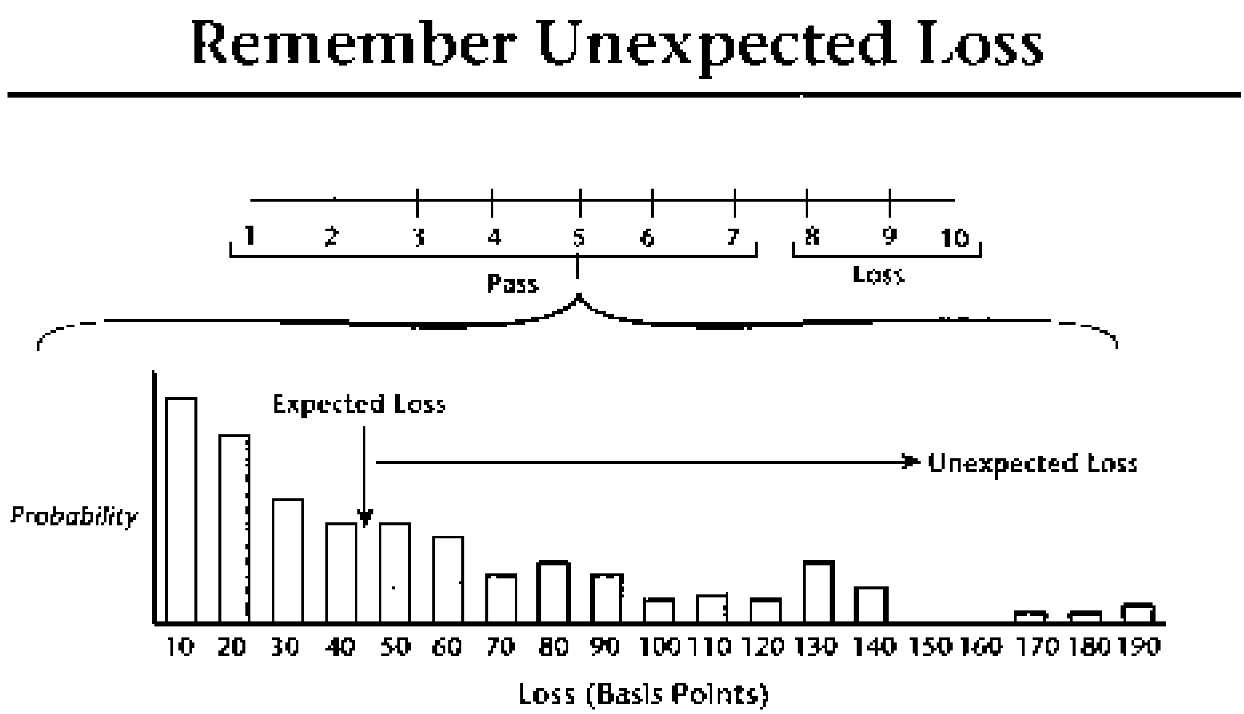
An important way to achieve this is more effective application of the latest information technologies. For banks, this is not a revolutionary idea. Until now, the focus has mainly been on payment transfers, such as automation of clearing transactions, the introduction of cash dispensers and electronic payment in shops. The basis for the automation was the standardisation of products and production processes. A further improvement in efficiency was achieved via interbank co-operation, especially in the development and exploitation of payment systems.

In the area of traditional credit provision, standardisation has made the least progress. In recent years, however, developments seem to have accelerated. Standard financing products will result in cost reduction and information technology plays a conclusive part in achieving this standardisation. It offers support in marketing, credit assessment and credit processing. More use of IT can help here, allowing small business lending to be approached in the same way as private lending. According to the American Advisory Board Company, banks who standardise product menus, loan application and lending standards, centralise credit analyses, document preparation and settlement, automate application processing systems, create objective systems for credit analyses, and limit reviews to delinquent loans, can double their profitability compared to competitors who do not adopt this strategy. However, working with standard products and the latest information technologies requires specific expertise and the existing staff in credit departments can be retrained only to a certain extent. It is doubtful whether the superfluous people can be found roles elsewhere within the bank. Thus in the short term, the cost-saving effect for banks of these efforts has to be regarded as limited, especially for banks that are lagging behind in the introduction of information technology.

2.4.2 Increasing profits

Apart from its advantages, standardisation also has drawbacks. An important danger is the "provocation" of competition. This can happen because standardisation makes the interest rates charged, pay-back conditions and commission on banking products comparable for everybody. More transparency puts the desired margins, and hence the profit, under greater pressure. A second factor that influences profits is competition within and outside the banking sector. An increasing number of banks has declared that SMEs are part of their core business with the result that, in most Member States, a major struggle to attract SME business has started.

Diagram 3: Typical Bank Commercial Loan Risk Grading Scale



Source: Loan Pricing Corporation.

All the players are trying to increase their market share. At the same time, more and more non-banking organisations, including insurance companies, building societies and venture capital funds, are entering the market for SME financing, thus putting profit margins under even more pressure. Finally, SMEs exert pressure on banks via their umbrella organisations to lower costs. This is done in direct talks or by means of political lobbying, playing on the crucial importance of SMEs for the economy as a whole, and employment in particular. More and more banks realise that the best way of achieving higher turnover, lower costs and thus higher profits on loans is to look after their current SME client portfolio. Long term relationships matter less when client and bank are discussing pricing, more so where access to credit is concerned. Figures produced by the American consultancy company Bain & Co show the effects of such a policy (see diagram 4).

2.4.3 Collateral

Until now, banks' risk in respect of SMEs was covered mainly by guarantees of a professional and private nature from the entrepreneur. An important development with which the banks are confronted at the moment is that the collateral being offered gives less certainty than before in case of payment problems. The shortening of the life cycle of products, the decreasing useful life of fixed investment and large fluctuations in the value of shares and immovable property all mean that banks must consider lower valuations of collateral. The banks' estimations of the execution value of personal and business guarantees are becoming even more conservative. There are also more new enterprises being founded, which have little or no material security to offer. This is true of many enterprises in the service industry, such as software houses and counselling businesses. Moreover, the personal assets of many (new) entrepreneurs are often insufficient to act as a supplementary guarantee. These developments make traditional financing based on physical security even harder. A solution has to be found in guarantees by third parties (e.g. loan/mutual guarantee schemes) or in financing based on the supposed aptitude of the entrepreneur for his chosen business.

2.5 BETTER FINANCING PRACTICES

Neither banks nor enterprises are completely satisfied with current financing practice. SMEs' desire to see more risk-taking and lower tariffs from banks contrasts with the necessity for banks to cut costs and reduce their exposure to risk. Although banks are subject to the rules of the market, they have launched many initiatives targeted on various aspects of financing which were designed to bridge this gap. Some of the initiatives undertaken by participants in the Round Table are outlined below, although the list is far from exhaustive. Government initiatives as such are not examined, though this does not imply that they are of less importance. The Dutch Loan Guarantee Scheme, for example, owes its success to the fact that the national authority took the initiative and left implementation to the banks. The decision to exclude government measures has been taken in order to show that initiatives to improve the climate for raising finance are possible even without major (financial) support from governments.

2.5.1 Less dependence on (fixed term) loans

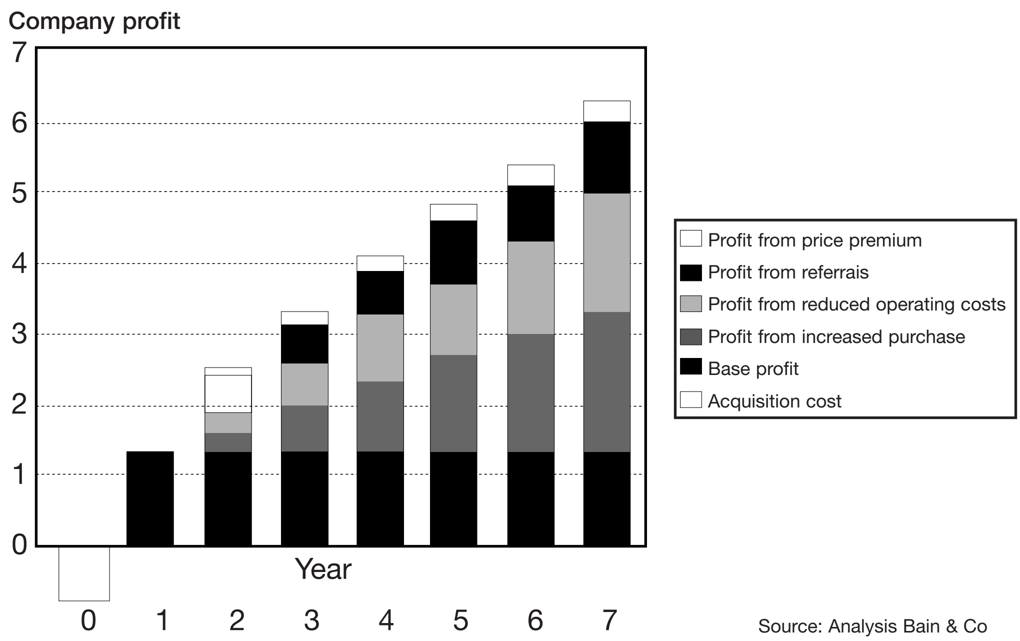
Leasing and, to a much lesser degree, factoring are the main elements in the group of non-loan products which banks can draw on for the financing of SMEs. The costs, however, may differ substantially from bank loans, as research from the Advisory Board Company indicates (see diagram 5), due to their different features. In order to make factoring more attractive to SMEs, a new company - Heartland Factoring - was set up in the Netherlands in 1996. Its target market is enterprises with an annual turnover of between 100,000 and 750,000 ECU and it will take on up to 80 percent of a client's debtors. Other products are also attracting more attention. These include bank guarantees and surety bonds, which are increasingly offered to clients outside traditional spheres of activity, as well as cash management activities, which represent the simplest way of reducing a company's need for loans.

Flexible financing is a top priority of SMEs themselves, a fact which is recognised by an increasing number of credit institutions. Most of the time, SMEs are given some **flexibility with regard to the repayment of the loan**. Such a concession can be especially helpful for enterprises where liquidity is temporarily under severe pressure, like start-ups and existing enterprises starting a new venture. The big British and Irish banks thus advertise flexible loans, whereby existing enterprises only start repayments after two years. In the meantime, only the accrued interest on the loan has to be paid. However, the repayment-free period is usually much shorter for start-ups. With Barclays Bank and NatWest it applies for six months. Within a special programme for micro-businesses, the Bank of Ireland offers three year interest-free loans.

Innovative SMEs not only need flexible terms of repayment, but also **flexible forms of financing**. In their early stages, they require relatively small sums of money to launch and develop their ventures; later on, however, their financial needs are quite considerable. In addition, it is hard to predict exactly how things will develop and what their specific needs will be in due course. Moreover, their lack of experience in finance often leads entrepreneurs to take the first funding they are offered. Very often this is unsuitable to their needs and ties the businesses to sources of funding which restrict their future growth.

To reflect this, NatWest offers a package of funding which includes a wide range of financial products. In practice it means that the entrepreneur, together with his account manager, looks for the right mixture of short term and long term lending. Where the products are outside the bank's own portfolio, for instance informal capital, subsidies and other incentives, NatWest arranges for these to be available as well. As a frame of reference, one works with a so-called "Wheel of Finance" that is frequently discussed with the entrepreneur (see diagram 6). For the entrepreneur, this package funding results in a financial structure which is truly appropriate to the present and future needs of his business, much more flexibility when he needs second and even third stage funding, more independence and control of his

Diagram 4: Building Profitability through Customer Relationships



Source: Analysis Bain & Co

Diagram 5: Annual Costs of Commercial Finance Products

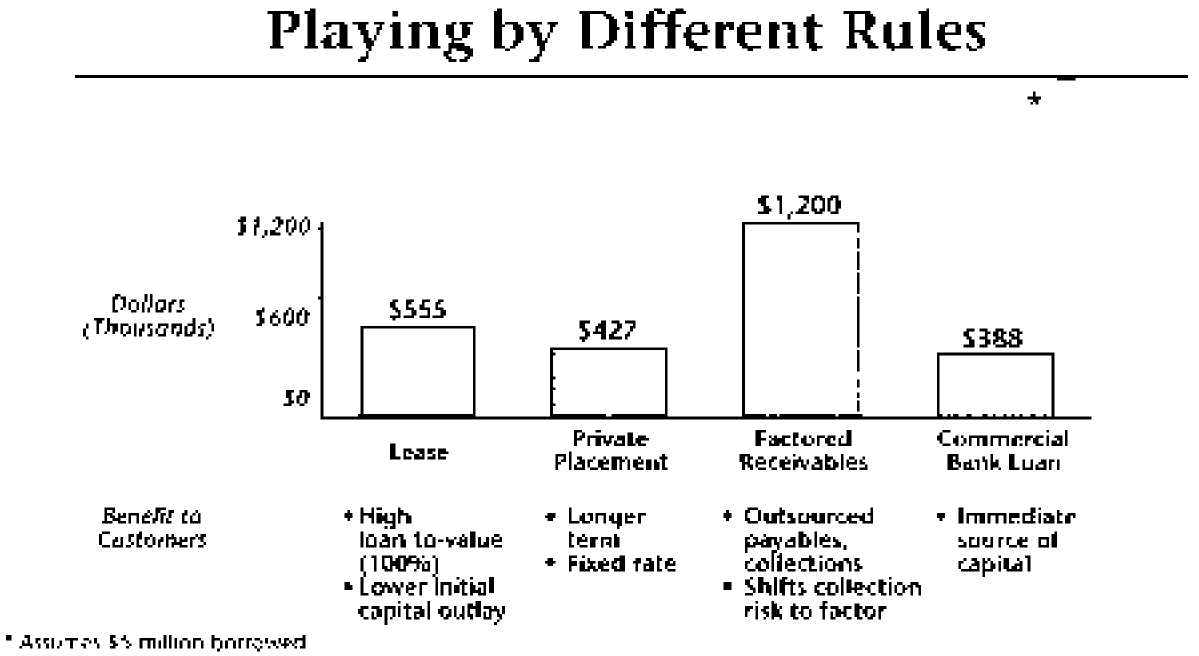


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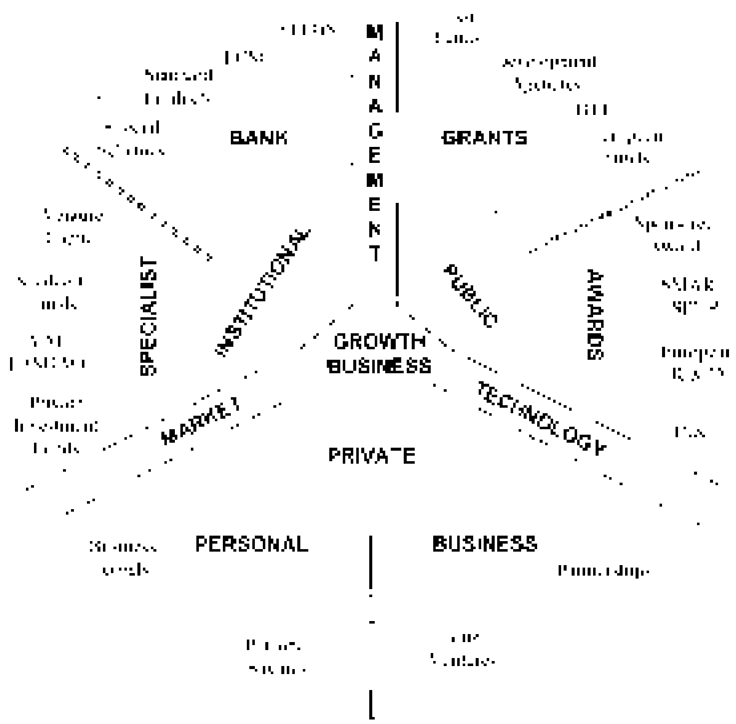
Diagram 6: Nat West's Wheel of Finance



© NatWest Innovation and Growth Unit 1993 company, fewer risks and lower costs because there are no fines or extra handling charges if the financial mix is changed.

2.5.2 Better adapted banking products

The area of product development where banks are currently most innovative in responding to SME needs is risk finance. In this field, the product closest to traditional loans is **subordinated loans**. In the event of a liquidation these rank after all other creditors and are therefore considered as part of the capital of the enterprise, helping it to obtain ordinary loans. To reflect the level of risk associated with such loans, they carry a higher rate of interest than conventional loans. Banks in several countries offer subordinated loans but tend not to market them very actively, often limiting their availability to better, established clients who may be experiencing temporary solvency problems as a result of, for example, restructuring after a take-over. However, they are becoming more proactive in offering subordinated loans and, in The Netherlands, the Rabobank and ABN Amro Bank even advertise this product for start-ups. Generally, subordinated loans are used by banks as the basis for a regular term loan. In addition, some banks offer **convertible subordinated loans** to young, particularly promising enterprises. These give them the right to convert the loan into shares in due course, thereby providing a little more certainty.

The problem of risk finance for start-ups which need little capital but are very risky because of unknown market acceptance, production efficiency and price has been addressed by banks in some countries (among which Great Britain, Germany, Ireland and The Netherlands) via the development of so-called **seed capital**. This is not a unique form of financing, but comprises various instruments, including equity and subordinated loans, in combination with soft loans. A common characteristic is the low return on investment with which the capital provider is satisfied. In fact, non-bank, regionally-based public providers of seed capital often seek no gain at all. To the extent that banks are involved, they have so far committed relatively small amounts to seed capital, usually through funds specially set up for this purpose. In addition, such funds will not normally provide all the finance required by an enterprise. The ING Bank, for example, which has a seed capital fund of 5 million ECU, limits itself to a 50% participation in the capital of any SME.

More important to SMEs than risk capital from financial institutions is capital supplied by family and friends. In order to stimulate the supply of this so-called **informal capital**, the authorities in various European countries have introduced regulations which give tax relief to providers of such finance, thus effectively extending the potential sources beyond the immediate circle of family and friends. In Great Britain, the market for informal capital which has developed as a result of such measures is estimated by experts to be in excess of 5 billion ECU, 5 times the size of that for venture capital: a market estimated by various European research institutes as being less than two percent of the total need for capital.

There are several explanations for this. Informal capitalists, often called Business Angels, take more risk and are satisfied with a lower return on investment than traditional venture capitalists. In addition, their costs for appraisal and monitoring appear to be lower, since they usually invest in activities in which they have previous experience. Furthermore, they do not demand a minimum level of financing like the venture capitalist. However, a huge problem for the informal capitalist is that the market is far from transparent. On the other hand, banks generally try to exploit the new possibilities which arise where there is a need for a mix of direct funding and bank finance. Bank of Ireland, for example, has developed an Equity Introduction Service whereby potential informal investors are matched to companies on BOI's books on a confidential and informal basis. A similar service is provided by NatWest under the name of NatWest Business Angels Service **(see case study 1)**.

A variant on NatWest's Business Angels Fund is a plan from 1995 originating from a working group appointed by the Danish Ministry of Industry (Erhvervministeriet) in order to raise a special **investment fund for unlisted SMEs**. A problem is that the present European directives, in order to protect consumers, forbid investment funds to put more than 10 percent of their money in unlisted enterprises. However, one advantage of an investment fund that Business Angels services lack is that the available capital can be directed more easily towards enterprises that are important to the national or regional economy, like start-ups. In practice, it appears that informal European investors, like venture capitalists, prefer existing to new enterprises. Moreover, the recipient of the capital does not need to worry so much about 'meddling' by a private informal investor. The Danes believe they can solve the problem of European legislation by placing the investment fund into another, larger investment fund for listed enterprises. The capital of both funds will then be considered as a whole. It goes without saying that the Danes believe that the investment fund for unlisted SMEs should be supervised by the government in order to prevent problems.

An investment fund for unlisted SMEs is independent of possible tax relief for formal investors. The chances of such an investment fund succeeding will be better, however, where such investment stimulation schemes exist. However, this still leaves another problem, namely the hesitation of many capital owners to invest money in small, growing enterprises for long, fixed periods. The risk of failure of such enterprises is relatively high. With informal capital in a one-to-one relationship this problem is even worse than with an investment fund. A working group, appointed by the French Ministry of Enterprises and Economic Development, has proposed the solution of appointing an **independent intermediary**. This person would assess the value of the shares at the peak of the enterprise and, on this basis, determine the return on investment that will be paid later on. If the entrepreneur cannot meet this obligation, the informal investor would have the option of drawing on his collateral.

Informal investors need not be people, but can also be businesses. Large enterprises are often willing to invest in smaller enterprises but they do not want to have a direct link with them. This has led to Irish and British initiatives to establish **Smaller Companies Investment Funds**. These are local funds, in which banks are involved. A local Business Broker has to stimulate the interest of regional enterprises to put money in the fund. In cases where the fund makes an investment, the participating banks commit themselves to provide the applicants with regular loans. Such funds are particularly suitable for start-ups and do not require too much effort to set up. Most of the work in Great Britain will consist of forging together various existing local support initiatives for small enterprises. In The Netherlands, too, such an initiative has been started, where the ING Bank and a local large enterprise both contributed half of the capital. The investment fund, with a working-capital of 50,000 ECU, is aimed at start-ups. The ING Bank has also committed itself to providing the enterprises in which it has invested with regular loans.

Companies themselves, with or without the support of banks, can also take the initiative to attract risk capital from the market. In 1996, six Finnish SMEs issued an **unsecured pool bond** of 12.5 million ECU targeted on institutional investors. The maturity of the bond is 5 years (bullet) with a fixed interest rate and each of the issuers is responsible only for his own part of the issue. Pooling enables SMEs to put together issues which are large enough to cover the expenses of the issue and to attract institutional investors. It also spreads the credit risk for an individual SME that participates in the pool. Usually, a company issuing a bond has to be quite large and well-known in order to ensure enough demand for the issue, but pooling makes it possible for smaller companies to access such fixed rate financing for risk capital.

In reality, venture capital is only an option for a very small number of SMEs. In the beginning, the provision of venture capital was a matter for specialised institutions but, since the 1980s, banks have also entered this market, some of them via separate subsidiaries. In spite of the latent need for it, little venture capital is actually sold, for various reasons. Firstly, the one-man enterprise, the most frequently occurring legal structure in the SME sector, is not well suited to participation by others in its capital. Moreover, the high risk associated with venture capital has to be balanced by a high return on investment, a fact which is often not recognised by SMEs. The good prospects which do exist, like high-tech start-ups, usually involve amounts below about 250,000 ECU but the high cost of the due diligence process means that these enterprises are also of little interest for venture capitalists. A considerable proportion of the remaining enterprises recoil from venture capital because of these consequences, namely the need to share profits with others and to allow outsiders to take part in decisions about business strategy. It is therefore not surprising that the market for venture capital is likely to remain at less than two percent of the total need for capital, a fact supported by various European research studies.

Moreover, the main European providers of venture capital, in contrast to their counterparts in the United States, show little interest in start-ups, preferring to concentrate their attention on existing, rapidly growing enterprises which require considerable injections of capital. Nevertheless, large institutional investors and banks in Europe have shown themselves willing to co-operate in a new initiative in this area - the foundation of EASDAQ (European Association of Securities Dealers Automated Quotation), **a stock exchange for SMEs** based on the successful NASDAQ exchange in the United States. The main objective of the new market, which opened in October 1996, is to improve SMEs' access to risk capital. For some SMEs, it offers an alternative to venture capitalists and, by permitting shares to be spread among a wider group of investors, helps to allay the fears of individual entrepreneurs about ceding control to one specific shareholder. Other, similar, more nationally-orientated initiatives are the Nouveau Marché in France and the Alternative Investment Market in the UK. The near future should see the inception of such markets in Belgium, Italy, Germany and the Netherlands.

2.5.3 Reducing the cost of finance

In countries or regions with relatively high interest rates for SMEs, the government sometimes offers interest rate subsidies to the entrepreneur. The interest rate subsidies are usually related to a specific purpose, like employment creation, machinery investment, craft, export, ecological protection. This is usually done via an agency, such as Mediocredito and Artigiancassa in Italy. The subsidy request can be made directly to the support agency or via the bank where the loan is granted. Apart from interest costs, other bank charges can also be subsidised. At the Bank of Ireland it is common policy to help **start-ups** through the difficult initial stage by reducing charges for banking services. Start-up entrepreneurs pay lower commission when taking out a loan and a lower charge for invoice discounting. Moreover, when the start-up is granted a term loan for business property, it receives an interest subsidy as well. In addition, start-ups with a current account pay no maintenance and transaction fees during the first year, no cash charges and commissions on drafts under certain conditions, no fees for night safe facilities and Company Credit Cards and no costs for export- and business-consultancy services. For this support, the Bank of Ireland receives no government subsidy, so the costs are absorbed internally.

Some banks also offer loans on relatively **favourable conditions**, provided that they are earmarked for **specific purposes**. This applies, among other things, to ecological projects. In the French region Haut-Rhin, the local Banque Populaire, in co-operation with various authorities, institutions and large enterprises, offers cheap loans to SMEs that have been able to show that the money is intended for environmentally friendly products and production processes. A Committee of Experts decides whether an enterprise is suitable to be considered for PREVair, a loan with a tariff that is about 40 percent below the market tariff. The Banque Populaire intends to expand the project to the neighbouring regions in Germany and Switzerland.

The costs of interest subsidies need not always be born by authorities or banks and hence, via cross-subsidising, by other bank clients. The proof of this is the **local loan funds** in Great Britain. These funds, founded by local bank offices and local business support groups, aim to make sure that start-ups and small enterprises with expansion plans can borrow money on prime rate conditions. To achieve this, both parties put £100,000 each for every fund as a deposit into a non-interest bearing account. Moreover, the local business support group commits itself to provide guidance to the entrepreneur who gets a loan. For every fund, 10 to 20 enterprises obtain loans, the average amount being £5,000. The bank incurs the full credit risk but receives compensation for the difference between the real and the preferential rate via the revenues from the retained deposit account.

Another project in this field has been developed by KERA Ltd, a state-owned special credit institution. Since the beginning of April 1996, KERA has been granting **special loans for start-ups**. Single loans are for amounts between 3,500 and 17,500 ECU and are aimed at companies employing the entrepreneur and up to four other people. The maturity of the loan is 5 years with annual repayments, the base rate being set at 6 months HELIBOR (Helsinki Interbank Offered Rate) with no margin (currently around 3.8%). The required collateral is very small compared to bank loans. Demand for these loans has been very promising - by the end of June 1996 (3 months), some 1,200 loans had been granted totalling 15.8 million ECU.

In order to achieve a favourable interest rate for entrepreneurs, one need not always look to subsidies, as the German Savings Banks have been demonstrating for some time now. An established part of their policy is that, for each request, the account manager seeks the **cheapest solution to the financing problem** of the SME entrepreneur. This involves looking carefully at all possible regional, national and European government schemes, examining the cheapest external financing possibilities first, before offering their own banking products. Thus the account managers must be well informed about the various schemes and have good contacts with all the relevant authorities, in order to ensure that all possible incentives can be used.

The entrepreneur himself can do much to reduce his financing costs. Firstly, by understanding and appreciating the risks which the bank is taking in relation to his enterprise. Only then is he in a position to negotiate meaningfully with the bank on tariffs. In Great Britain, the Forum of Private Business has taken an interesting initiative that supports the entrepreneur in this area. It concerns the development of a **Risk Assessment Form** which, once filled in by the entrepreneur, gives a risk profile of his venture. It is based on criteria which are closely related to those used by banks. Currently, some British banks even distribute the form directly to their SME clients **(see case study 2 and Annexe 4)**.

The situation is helped when the entrepreneur's own view of his enterprise is complemented by an objective overview of its financial position. The Finnish Balanssi Programma, launched by the Ministry of Trade and Industry in co-operation with the Confederation of Finnish Industry and Employers (TT), aims to provide just this. By means of a **quick scan** that usually takes two days, independent experts try to analyse the financial position and needs of the company. This forms the basis of an action plan which is discussed with the entrepreneur. The negotiation strategy with the bank is also reviewed. The costs of a quick scan are paid by every entrepreneur, but are very moderate.

A similar initiative has been taken by the Barcelona Chamber of Commerce in co-operation with the savings-bank 'La Caixa'. This is also based on an analysis of the enterprise but differs from the Finnish approach in that it involves a **combination with financing**. Part of the deal with the bank was running a fund of 1.3 million ECU, over a period of nine months, with the objective of supplying soft loans to the participants in the project, all members of the Chamber of Commerce. Because of its great success, the co-operation has been extended beyond the original time limit. The risk and costs of the advantageous loans are completely covered by La Caixa.

It goes without saying that the financial performance of the business is not the only influence on the interest rate charged - the qualities of the entrepreneur matter too. NatWest has developed two initiatives that reward business(wo)men who make an effort to improve their entrepreneurial qualities. Start-up entrepreneurs who have attended a management course of the British Training and Enterprise Councils can have **18 months free banking** with NatWest. Existing entrepreneurs who did the same at the Norfolk Small Business Initiative were rewarded with a 1 percent **reduction on the rate of interest** charged on their current account or a **reduction** of 190 ECU **on other banking charges**.

The prices charged by banks are closely related to their funding costs, i.e. the costs they have to pay to attract money from the capital market. Even on a small scale, initiatives to reduce these costs can be taken, as the Belgian grassroots organisation 'Network Flanders' shows. One of its projects involves procuring soft loans for small social and ecologically friendly enterprises, including small co-operatives. The loans are provided by the ASLK bank through a fund founded especially for this purpose, with the money for the fund being raised by Network Flanders. To do this, the organisation has opened a special savings account with ASLK for people and enterprises who sympathise with this project and who are satisfied with a lower interest rate on their savings. For its efforts, Network Flanders receives a commission of 1 to 2 percent of the sum saved.

Another way to reduce costs is to deal with business risks more effectively. Small, innovative enterprises present a huge problem in this respect. How great are their chances of success or failure? In general, banks do not have sufficient knowledge to give a well considered answer to this. In order to assist investors, facilitate the introduction of new instruments and encourage development of financial markets, a Rating Agency, called Italrating, has been founded by Mediocredito Centrale, the Chambers of Commerce network and some other organisations. Italrating's purpose is the assessment of creditworthiness of small and medium-sized Italian companies **(see case study 3)**. Another initiative has been taken by the ING Bank in The Netherlands under the name of 'techno-rating'. This initiative is supported by the Dutch Ministry of Economic Affairs, by the Network of Dutch Innovation Centres and, more recently, by the other big banks in the Netherlands. An independent organisation has been set up by all participants to carry out the rating.

2.5.4 Raising the upper limits for bank finance

When the guarantee of the enterprise and the entrepreneur are insufficient for the bank to provide the financing requested, other external collateral must be found. In many countries where such support is absent or insufficient, other parties sometimes offer a helping hand. In France, local SMEs give guarantees to each other. There are 115 active **mutual guarantee funds**, backed by 300,000 trading and industrial enterprises, and together they guarantee an amount of about 1.6 billion ECU. In some French regions, public institutions supply so-called counter-guarantees or partly reinsure the contractual risks. Reducing risks in this way has the effect of increasing the local mutual guarantee fund's potential capacity. This policy is used especially in regions with a small number of wealthy companies **(see case study 4)**.

Mutual guarantee funds also exist in other EU countries, often operating at regional level, sometimes at **sectoral level** as well. There is a European Association of Mutual Guarantee Schemes with 7 EU members, shortly to be extended to 11 members. The Netherlands does not have a mutual fund because the government scheme functions well. Nevertheless, here too additional loan guarantee funds have been raised through private initiatives. They aim at **specific target groups** which banks consider particularly risky, such as enterprises founded by women or by people who belong to ethnic minorities. One organisation that gives an additional loan guarantee to the banks on behalf of women entrepreneurs is Mama Cash. The money for this fund comes from legacies and gifts from supporters of the idea **(see case study 5)**.

Italy has more than 500 mutual loan guarantee funds but these work differently from those in France. The Consorzi Fidi, as they are called, are not connected to one particular bank. Furthermore, they offer not only guarantees for enterprises, but also support them by presenting their business plan to the banks and negotiating about soft loans and the interest rate for regular loans. This means they are pressure groups as well. The double function appears to be successful in practice and is hence supported by the Italian SME organisations.

There is often little external support available for entrepreneurs who need to obtain a guaranteed loan. To make loan guarantees more available to SMEs and to introduce a certain competition element, the European Commission has asked the European Investment Fund to run a loan guarantee scheme - the Growth and Environment pilot project -

which facilitates the access of small companies to bank loans for investments producing environmental benefits.

In order to provide an alternative to official loan guarantees, a committee set up in 1996 by the Federation of Finnish Industry and Employers looked at the use of **covenants as a security** for SMEs. It made several recommendations: banks should accept covenants as a replacement for collateral or as additional security; the Finnish Financial Supervisory Board should examine the use of covenants and improve their usability; and the Ministry of Trade and Industry should set up a committee in order to develop structured covenants which could be widely accepted by financial institutions. The impact of a covenant could be felt in several ways, for example: a request for the SME to report its financial status to the bank more often and in greater detail; an obligation for the SME to ask the bank's permission before making large investments which could endanger its solvency; or an obligation for the bank to charge lower interest rates and fees if the financial position of the customer stays above agreed limits, with the possibility for the bank to increase interest rate margins and fees (or call in loans) if the SME breaches these limits. The committee's suggestions have met with quite a favourable response from Finnish banks. OKOBANK has started to formulate a policy on how the use of covenants as security for SMEs could be systematised.

3. Improving communication

Good segmentation of the SME portfolio and effective use of the distribution channels available for each segment are prerequisites if banks are to establish a fruitful relationship with their SME clients. However, segmentation, distribution concepts and organisational structures merely represent the framework within which the relationship has to be built. The ultimate success of the banks' service to SME clients is determined by the way in which communication is developed.

There are three distinguishable aspects to communication: first, the degree of openness which the parties show towards one another; second, the extent to which the parties are on the same wavelength; finally, the extent to which each of the parties is prepared to devote time and energy to the relationship. Good communication will only result if all these elements are present, a fact which must always be borne in mind when examining how to improve the relationship between banks and SMEs.

3.1 THE BENEFITS

Good, intensive communication between parties results in close relationships, with benefits for both banks and SMEs. Banks can recognise the problems or needs of their clients earlier on, allowing them to take prompt action in response which, in turn, results in satisfied clients willing to pay for good service and less likely to consider changing bank. Feedback from clients provides valuable information which banks can use to develop and refine their policy in order to improve both their internal organisation and the services they offer. Banks also benefit in the area of risk management. A deeper, clearer insight into how their client enterprises are functioning allows them to place more reliance on the information provided by the clients and less on the collateral they hold. Moreover, banks which enjoy close relationships with enterprises can often obtain useful information about the state of affairs in other client enterprises, helping them to maintain the quality of their SME portfolio. Finally, close links with clients can actually yield more profit as well, by increasing the possibility of cross-selling and providing introductions to potential new clients via the entrepreneur.

SMEs who communicate well with their banks benefit too, often getting better advice and support than their less communicative counterparts, which can be particularly important when they wish to pursue new opportunities or tackle awkward problems. Banks may also make more effort on behalf of these clients, such as by introducing them to the bank's contact network, including public institutions, suppliers and purchasers. This helps SMEs to understand the way their bank works, leading to a more stable and balanced relationship and removing some of the entrepreneur's concern about how the bank might react if he encounters problems. They may also gain more value from the various banking products and services as a result of more inside information being available from their account manager. In addition, an open relationship should make the bank both more willing to provide finance and less inclined to insist on substantial material guarantees. Finally, banks are better able to calculate the risks they are exposed to, often allowing them to charge less for loans as a result.

3.2 EXISTING PROBLEMS IN THE RELATIONSHIP

Several research studies show that communication between SMEs and banks, and hence their relationship, is a significant problem which manifests itself especially when economic conditions are difficult. When a company suffers a setback in business it may need to borrow more, whilst at the same time being able to offer less collateral and requiring a lower interest rate. Banks, on the other hand, have a tendency to become less flexible under these circumstances - more people get involved in the case, the bank's interest is put first, the chances of credit being withdrawn increase, there is less inclination to allow a moratorium, more collateral is requested and the cost of additional credit is invariably higher. This sort of pattern can also be observed when banks themselves are experiencing trading difficulties - they become more conservative, hesitate to enter into new contracts, concentrate on the profitability of their products, try to divest themselves of marginal customers, ask companies for much more information and adopt a strict attitude towards unauthorised overdrafts. However, when a closer, more established relationship is in place, it is easier to bridge the gaps and account managers in particular will argue in support of their closest clients. The British SME organisation Forum of Private Business rightly advises its members that it is essential to build up a good relationship with their banks while times are good, so that both parties will be better placed to weather more difficult conditions.

Unfortunately, as regards communication, certain aspects of the behaviour of both banks and SMEs lead to problems in the relationship.

3.2.1 Transparency

One of the most frequently raised complaints from SMEs concerns banks' unwillingness to explain their working methods, especially in the areas of granting credit and risk classification. SMEs often do not know how their request is handled, how long it will take before they receive a decision, what the true reason for a rejection may be or, when applying for credit, what may be the justification for charging a high rate for risk. Moreover, entrepreneurs often find it hard to understand how banks deal with enterprises that experience problems in meeting their repayment obligations. Is a warning issued before banks step in? Can this be appealed against? Banks' policies in time of recession are a particular source of discontent. Sometimes entrepreneurs are heard complaining that a bank suddenly became less flexible in its approach even though the situation in the enterprise gave no cause for concern.

For their part, banks complain about the entrepreneurs' failure to provide them with adequate information - they lack openness, withhold certain data and may even try to provide false information. A number of explanations are offered for this sort of behaviour. First, gathering the information which the banks ask for costs money. Second, the entrepreneurs' unwillingness to supply the information often derives from mistrust of the bank. What will it do with the information? Will it be used against me in the future? Will competitors gain access to sensitive facts because of defective banking procedures or indiscreet employees? Moreover, many SMEs lack the capacity to provide the required information in time, especially when banks ask for additional information to support a request for financing. Finally, much of the available information is actually useless for banking analysis and planning since it is gathered for other reasons, such as paying (as little as possible) tax to the Exchequer.

3.2.2 Knowledge level

An important precondition for good communication is that both parties are on the same wavelength. In order to achieve this, the knowledge level of each party has to meet the expectations of the other, but both banks and SMEs are often deficient in this respect.

The main problem for banks derives from the quality of their relationship management. SMEs are often heard to complain that account managers have insufficient knowledge. For banks with a more centrally controlled network structure, this criticism is aimed mainly at account managers' knowledge of the circumstances of local trade and industry, whereas account managers of smaller, local banks tend to be reproached for not knowing enough about the bank's products. In both cases, the most severe criticism is levelled at the approach adopted towards small enterprises and enterprises in rural areas. The cause of this situation can often be traced back to the analysis of costs and benefits made by the banks and the lower status that these particular target groups still have all too often. This tends to make banks fall back on older, experienced but less highly educated staff, or young, well-educated employees with limited experience. Added to this, account managers usually did not stay in their position very long, especially in the centrally controlled network banks, and this is still the case in some banks today. As a result, they do not have time to build up in-depth knowledge of the enterprises in their portfolio or of the local circumstances in which they operate.

Some of the communication problems experienced by SMEs can be partly attributed to the fact that entrepreneurs either lack, or do not have access to, financial knowledge. This leads to a flawed financial policy and management, excessive personal withdrawals from the enterprise and the supplying of incomplete or incorrect information to the banks. Improving this situation is not the top priority of most entrepreneurs - they prefer to leave financial policy to external administrators or accountants which can lead to obscurities and misunderstandings in the bilateral contract between entrepreneur and account manager. It should be noted, however, that although there is still no unambiguous correlation between the educational/financial knowledge level of entrepreneurs and the eventual chances of survival of the enterprises in question, it is clear that lack of financial knowledge in enterprises impedes communication and hence the relationship between entrepreneur and bank.

3.2.3 Effort

Only when both parties are willing and able to invest enough energy in each other is there a basis for a fruitful relationship. This is an area, however, where both banks and SMEs sometimes do not put in enough effort.

For many banks, finding the right form of relationship management for SMEs is still a problem, so some or all of their SME clients do not get the attention they deserve and need. It cannot reasonably be expected that an account manager - who will move to another position after a few years, has insufficient latitude for making his own decisions, is not well-trained for his task and may lack experience, has far too large a portfolio of clients (often up to 250 entrepreneurs) and may be overloaded with back office work in addition to his main functions - will put too much energy into building up and managing relationships with clients. Under these circumstances, it is understandable that clients will not invest the time and effort in establishing a personal bond with the bank.

A second problem for banks arises from the quality of the services they supply to SMEs. It is still not common to find quality assurance and formal complaints procedures within banks, while advising and supporting clients, reacting to the specific needs and wishes of enterprises, appear to come second to selling financial products. There are good reasons for this. First, even in the most efficient organisations, the costs of advice and support generally exceed the income generated, especially as far as SME clients are concerned.

Second, banks tend to be cautious in giving advice and support in order to avoid taking on a possible (moral) obligation as a result of becoming too intimately involved with an enterprise. There can be several reasons why a bank may wish to assist an enterprise while still staying on the sidelines, the most recent of which is the bank's possible legal exposure when it gives advice. There have recently been lawsuits in both Germany and Great Britain where banks have been held responsible for losses suffered by enterprises due to supposedly incorrect advice. In view of the rising tendency to seek legal redress and the unfavourable outcome of a number of the lawsuits, banks in several countries have adjusted their policy. In Great Britain, Germany and France, for instance, they no longer offer advice or suggestions on how particular management decisions should be taken. More and more they limit themselves to giving only general (financial) information and advice.

SMEs also do things which are not very conducive to the development of a close personal bond with their banks. One example is so-called shopping around, whereby they play banks off against each other in order to obtain products at the lowest prices and on the best terms. The banks complain that entrepreneurs are only concerned about their relationship with the bank when problems have arisen which they cannot work out by themselves. The majority of SMEs unfortunately only approach their bank when they are already in severe financial difficulty and there is not much left that the bank can do. Entrepreneurs also have a tendency to wait until the last moment to involve the bank when they hand over the company to someone else. There are, however, numerous entrepreneurs - sometimes even the same ones who leave it to the last minute to contact their bank when they have problems - who make considerable demands on account managers' time for minor queries which they could probably sort out themselves.

Besides putting too little energy into the relationship, SMEs may also put in totally the wrong sort of energy. This has not been a major problem up to now but it might become so in the future. Specifically, an increasing number of entrepreneurs seem to want a confrontation with their bank. Sometimes they accuse the bank of having withdrawn their credit line too soon, pushing them into an irrecoverable financial position. Sometimes they are already in financial trouble and blame the bank for not having done enough to help them, claiming that their problems would not have arisen if the bank had paid more attention to them and given them adequate warning. This does not, however, imply that banks should also control the business and does not mean that accusations are the norm. A number of entrepreneurs, however, have already instituted legal proceedings against banks in such cases. If the courts order compensation to be paid in any of these cases, there could be far-reaching consequences for the relationship between SMEs and banks and it is certain that the innocent will suffer too.

3.3 BETTER PRACTICES IN COMMUNICATION AND RELATIONSHIP MANAGEMENT

It goes without saying that optimising the three basic elements of good communication will create the conditions in which the relationship between banks and SMEs can be improved. In fact, several banks and some SME organisations have already taken initiatives in this area in order to try to achieve the desired improvements.

3.3.1 Increasing transparency

In order to induce entrepreneurs to adopt a more open attitude towards the bank, the Commercial Bank of Greece **rewards good co-operation**. High value clients who deliver information on time and in as complete a form as possible may receive a discount on their loan rate. A similar rule has been introduced by one of the Deutsche Sparkassen, an experiment under which clients periodically have to provide certain concise data on a floppy disk. This information is used by the bank to make a prognosis for the company's future development which is fed back to the entrepreneurs (who participate in the scheme on a voluntary basis) along with a discount on their loan rate.

Sometimes banks will themselves adopt a more open approach, even if it makes them vulnerable. All large British banks, for instance, have drawn up a **Code of Practice (see Annexe 2)** for business banking and distributed it to their clients. The code describes the standards that the banks have set themselves for ensuring that the client knows exactly where he stands in his everyday banking transactions and there is also a section on what the client can do if something goes wrong in the relationship. Other such codes have been issued by the Banks Federation in Ireland and by the European Savings Banks Group.

The initiative of the French SME organisation CJD (Le Centre des Jeunes Dirigeants d'Entreprise) intends to go further than the unilateral, but not legally binding, Code of Practice in Great Britain. CJD has drawn up a **banking contract** for its members/entrepreneurs and for the banks with which they do business, in which both parties commit themselves to honour a number of agreements. The contract obliges the entrepreneur to provide the bank periodically with information on his trading results and forecasts, to draw up a strategic medium term plan, to give the bank access at all times to any relevant documents, to undertake additional training in order to improve his financial skills and to call on the help of other CJD members when necessary. The bank, in turn, agrees to provide its staff with continuous additional training, to visit the client regularly, to organise financial training for entrepreneurs, to give an assessment of the present capabilities of the (young) entrepreneur, to draw up an analysis of the enterprise at least once a year, to tell the entrepreneur what sort of criteria will be applied when examining a request for finance and to indicate clearly the reasons for refusing to grant a loan. Up to now, only three French banks have adopted the CJD contract. In addition to this, a **charter** is being drawn up in France by the national government which will lay down a number of rules for banks' conduct when dealing with SMEs.

Another initiative from the SME side to induce the banks to be more open is a **price comparison** of the main banking products carried out by the Dutch SME organisation KNOV (now MKB Nederland), in which all large Dutch banks were asked to co-operate. Research was also carried out among the members about their experiences with banks as regards the setting of tariffs. The research showed that there were large price differences but that no clear indication could be given as to which bank was best, since this depended largely on the nature and circumstances of the company itself. Thus the study concluded that shopping around by entrepreneurs was somewhat futile but that the figures should rather be used as support for negotiations with their own bank. Since the appearance of the study, many banks have become much more open about their pricing policy. The Dutch Postbank, a subsidiary of the ING Group, has adopted the price comparison of the KNOV and periodically shows in an advertorial the prices that the large Dutch banks charge for their products.

Another way to create more openness is to establish a commission for settling disputes, to which both bank and client can appeal in case of disagreement. In Great Britain and a number of other European countries there is an **Ombudsman** or **Parliamentary Commissioner** especially for the banking sector. He is the central point of recourse for clients who are having problems with their bank and his judgement in a dispute is binding. In Ireland there is an Ombudsman dealing with complaints about banks. In Sweden the Consumer Banking Bureau hears complaints and offers free advice and guidance for potential and existing bank customers. At the Spanish Savings Banks the central point is within the regional banks in the so-called Customer Care Service **(see case study 6)**.

3.3.2 Quality improvement

The most obvious way for banks to strengthen their relationships with SMEs is to increase the quality of the services they offer until it meets the level required by the SMEs. There are many ways to achieve this goal. First, by offering **specific financial services** for business situations not covered (any longer) by the bank's standard products. These are normally required in problematic situations, such as a large scale expansion of the enterprise, mergers and acquisitions, product innovation, business relocation, questions of succession and so on. These so-called crossroads situations, where the structure or even the survival of the enterprise are being discussed, often require an optimal mix of, say, loans, venture capital, grants, advice and guidance. Targeted support of enterprises which face such serious decisions can not only help the relationship to develop at the time, it can also create a lasting bond. A good example of how to approach such companies is SPEF, a subsidiary of Banques Populaires Ingénierie. This company works for all the affiliated banks and is specialised in financial engineering for businesses at crossroads situations, offering (or having access to) the expertise to deal with any set of circumstances.

Banks often do things **outside the normal range of financial products**. This can enable them also to achieve quality improvements in situations where entrepreneurs need to find solutions. One example is the export service that OKO Bank has founded in co-operation with a number of other Finnish organisations. This grew out of the economic recession in which Finland found itself after the collapse of the Soviet Union. Since the domestic market is quite small, many enterprises are forced to concentrate on foreign markets instead. The project screens potential new export companies and provides them with a tailor-made service package which is designed to help them take the first steps in exporting. Another initiative to help exporting companies has been launched by the German Savings Banks and Giro Association (Deutscher Sparkassen- und Giroverband). The organisation has founded Industry and Trade Centres in Singapore and Hong Kong where SME clients can present their export products at an attractive price.

Banking initiatives for quality improvement are not limited to particular business situations but can be aimed at the quality of SMEs in general. Databases built up as a result of the huge investments in information technology play an important role in this. Several banks supply industry sector information to their clients, for example the Information Services of the German Savings Banks **(see case study 7)**. This part of the co-ordinating organisation supplies information brochures on a number of subjects which are of interest to entrepreneurs and maintains a database which they can interrogate. The database holds 120,000 annual reports, allowing comparison of 2,500 types of business by trade, legal entity and size. The material is used to answer specific questions from affiliated banks and clients and for bi-annual forecasts, although the latter are prepared for only 25 business sectors at the moment. However, the new computerised data system, which has been developed in co-operation with two German databanks, should permit more forecasts and information to be provided.

Another way to help entrepreneurs improve the quality of their company is to give seminars and training sessions. Some banks go further and try to assist the entrepreneur in making new contacts or in cementing existing bonds. As an example, various Belgian banks have founded so-called company clubs at regional level, consisting of SME entrepreneurs, representatives of business associations, enterprise agencies, public bodies and educational institutions. The members meet frequently with the aim of helping each other out.

It is obviously important that banks do not just spend time trying to improve the quality of their clients, but also do the same for their **own organisation**. One of the instruments used to achieve this is the internal quality desk which develops, implements and guarantees a quality system for the bank. Several banks have such a quality desk but their experiences differ due to factors such as the position within the organisation, the task package and the level of authority. The experience of quality improvement which CERA Bank has acquired shows that it is important to involve all the responsible managers in the bank and propose measurable targets that must be attained within an agreed period.

Within the framework of quality improvement, most banks undertake **customer satisfaction surveys**. NatWest keeps a client service index by holding a survey of 30,000 business clients on a quarterly basis. The subjects discussed range from the quality of the service supplied to the use of the products offered and the survey results are reported to the regional directors of the bank for further action. In The Netherlands, an independent research institute, on its own initiative, carries out a large scale opinion survey among the clients of banks every three to four years. The results are sold to those banks which wish to use them for developing long term policy and are available only within banking circles. In Great Britain, such research on the relationship between SMEs and banks has been conducted by the SME organisation The Forum of Private Business since 1988, mostly among its members. The results are sent not only to banks, but to all participants and any other interested parties. Research such as this exerts considerable pressure on banks to take remedial action where necessary.

In order to ascertain the opinion of entrepreneurs on the quality of the bank or its products, banks do not have to wait for opinion surveys. Several banks make use of so-called **user groups**. One such bank is Banque Générale du Luxembourg, which also sees here an opportunity to involve clients more closely with the bank. Depending on the product or service being examined, a number of representative SMEs are asked to participate in the client panel. They first fill out a client satisfaction questionnaire, the results of which are analysed and then sent to them. This is followed by a workshop with the participants where the results are discussed and the priorities for the bank established. It is important that the bank commits itself to taking immediate action, to introduce the necessary improvements and to ensure that the participants are kept informed about progress. This approach has only recently been introduced but the intention is to repeat the process every year for each subject, using roughly the same participants, so that it will be possible to establish whether the entrepreneurs have noticed any improvements.

One possibility which allows even greater involvement in the bank's affairs is giving **seats to representatives** of the client group on the official bodies of the bank. In the co-operative banks it is usual for clients as a group to have a seat on the board, since they are also shareholders of the bank. At the Austrian OVAG Bank, as in most other co-operatives, every shareholder has one vote **(see case study 8)**. At the Groupe Banques Populaires, the direct influence of SMEs extends to daily routine at local level. The policy to be followed by the 30 independent banks that are affiliated to the group is decided by 431 members of the board, of whom around 300 are also SME entrepreneurs. Thus the SMEs have a very powerful position within the bank.

It is not just in the co-operative banks that clients can influence policy, however. The ING Bank, as a commercial bank, has reserved at least one seat on the Board of Directors for a representative of SMEs, a seat which, until now, has been occupied by the chairman of the Dutch SME association, MKB-Nederland. Moreover, the Management Board of ING has founded an **SME Advisory Board**. This involves the most important representatives of SME (trade) associations (around 25 people) who meet four times a year with the member of the Board of Directors within the Group who is responsible for SME policy, to talk about developments in the various business sectors, the policy of the Dutch government and the policy of the bank with regard to SMEs. The advice given is not binding but the bank attaches considerable weight to it. Mediocredito Centrale has also founded an Advisory Board where the bank's directors meet important Italian entrepreneurs for discussions on exporting, finance, development of new markets, etc.

3.3.3 Creating affinity

The present trend in the financial sector towards greater efficiency is likely to continue until all banks have reached an optimum level of efficiency. Once this point is reached, the battle for clients can no longer be fought with the weapon of prices and the conclusive factor in banks' commercial policy will become the affinity they have with their clients. This is particularly true for SME clients - banks need to understand what the entrepreneur does, what motivates him and what he spends his time on. An increasing number of banks are trying to do this at the moment through **human resource management**. It is no longer enough just to know your products - bank staff dealing with SMEs also need considerable knowledge of entrepreneurs and their businesses. Beyond this, affinity with clients demands a highly flexible mentality on the part of commercial staff, since this is exactly the sort of behaviour they encounter in entrepreneurs. This implies that staff need to be finely tuned in to the signals coming from their clients and must be able to offer effective solutions to their requirements. Thus affinity with clients must be expressed through the commercial staff and hence through the bank as a commercial entity.

When selecting new front office staff for the SME market segment, it is important to pay considerable attention to their background and experience with such enterprises. A number of banks focus strongly on recruiting well-educated people who come from an entrepreneurial family or have themselves run a company. It is then necessary that they stay in their post for longer than has been the case in the past, so that they have time to develop a close relationship with their clients. To enable the right people to be recruited from within and from outside the bank, it is necessary to put in place a framework that motivates a large number of employees to work with SMEs over an extended period. This can be done by giving them both high status and rewards and by offering proper **career planning** within the SME market segment. NatWest, for example, has three types of SME Account Managers: Small Business Advisors, Business Managers and Corporate Managers for Mid-corporate Businesses. It is also possible to keep relationship managers in the SME market segment for longer by offering training. Although no specific training is required to become an SME Account Manager at NatWest, part of the account managers' training is carried out at renowned universities, such as Durham, thus enhancing its status.

Apart from making it attractive to work with SMEs, it is also important to provide employees with **sufficient support** to enable them to build close relationships with clients. One way to achieve this is to give front office staff thorough training. Swedbank, for example, started a Business Training Programme for 1,000 of its account managers **(see case study 9)**. By providing training in both theory and practice, with case studies, personal involvement, mentoring and tests, the aim is to improve the staff's capabilities and efficiency, including the social competence needed for day-to-day work with SMEs. A new training programme for 250 middle management staff is planned as well, which will offer seminars on themes such as SME psychology, business decision-making and relationship management. NatWest has also developed a programme which focuses on SME behaviour and conduct **(see case study 10)**.

Once he is actually working for SMEs, the front office employee needs help to **free as much time as possible to spend with his clients**. This can be done by minimising back office work and by equipping account managers with portable tools such as laptop computers, which enable things like credit risk assessment, pricing and document preparation to be done at the client. Apart from saving time and reducing costs, the use of computers gives the account manager more confidence in his decisions and demonstrates to the entrepreneur that he is dealing with someone who has the authority to take those decisions. Both aspects help the relationship to intensify.

The front office employee must also be able to **rely on experts** for advice on specialised areas, such as innovative and high-tech enterprises. To support its staff who deal with these target groups, NatWest has developed two initiatives. The first is the foundation of the Technology Business Manager Network, consisting of 200 specially trained technology Account Managers, located across the country, who provide information and advice and may even grant credit. The second is the New Technologies Appraisal Service, whereby external experts in technology and marketing judge financing proposals on their technical and commercial feasibility. Girobank Bikuben has experts on exporting grouped in the Export Consultancy Service **(see case study 11)**.

Where loan requests come from SMEs who wish to market an invention, a new technology or a technical advance, banks are heavily dependent on the opinion of external experts, since the banks' own loan specialists are not normally in a position to make judgements on complex technological issues and evaluate their risks and chances of success. For this reason, the DSGV (German Savings Banks and Giro Association) launched a pilot networking project **(see case study 12)**. Other banks also make use of external experts to support their front office staff. The ING Bank has recently founded a joint venture in co-operation with the organisation for Dutch SMEs, MKB Nederland. The joint venture includes the previously existing advice unit MKB Advies (SME Advice) and all its employees, to which ING staff direct SME clients when they are unable to answer their questions personally. MKB Advies will also collaborate with Dutch accountants so that there should be no competition between the two types of advisors which might upset the traditionally good relationship between the bank and accountants.

Putting great responsibility on the shoulders of front office staff means that some degree of **supervision** is necessary. Problems can arise because the client and the bank officer do not get along well or because a client is looked after by the same person for too long. This can result in the officer becoming too close to the client and in the client gradually forgetting that he is there primarily on behalf of the bank. To avoid relationships being derailed, banks take various actions, ranging from a signed contract which lays down all the rules of conduct, to mystery shopping (sending pseudo-entrepreneurs to the bank in order to see how the employees perform). NatWest intends to launch an initiative within this framework, whereby outside observers will assess SME account managers. However, another danger which can arise from long and intensive relationships is that account managers can get their priorities wrong or lose their motivation. To keep them disciplined, CERA Bank frequently uses a bonus system which relates profit sharing to the profit generated from clients.

Front office employees play a key role in stimulating the affinity between bank and clients, but the bank as an institution should make clear its desire to develop a sustainable relationship with SME clients. This must be done primarily through the day-to-day contact with clients by supplying good service, being transparent, understanding the clients' needs, striving to offer the lowest possible prices, etc.

It can also be achieved by having **contact with clients outside the formal business relationship**. In 1995 the ING Bank started a national SME Day, on which all 80 of its larger offices each invite 150 to 200 SME entrepreneurs and their partners from the office's geographical area. In addition to this event, the bank organises a meeting for SME intermediaries from all over The Netherlands every three months. The meeting, which attracts 250 people on average, consists of a short lecture on a particular subject and then a longer informal section which is meant for networking. Other banks have a somewhat more limited but nonetheless effective approach, such as sending a token in recognition of the fact that their custom is valued.

Finally, the bond can also be reinforced by involving entrepreneur clients in the activities that the bank undertakes for other entrepreneurs. Since it is important that the entrepreneur can identify with the purpose of the activities, it often helps if they have a local focus: the Groupe Banques Populaires' mutual loan guarantee schemes work in this way. The same effect may result from the plans of some banks to create so-called local SME investment funds where local entrepreneurs take shares in a fund, managed by a bank, that puts money into small, local companies with good prospects.

4. Supporting entrepreneurship

4.1 GOOD PRACTICES IN QUALITY IMPROVEMENT

Banks in most Member States go beyond merely serving their clients and invest a lot of effort in supporting other entrepreneurs or SMEs in general, even though this may not be cost-effective in the short term. Although the scope and intensity of action taken may vary, the objective is always to improve and enhance the quality of entrepreneurship. Since the beginning of the 1980s, the number of activities and projects - for national, regional and local businesses - has steadily increased.

There are three distinct target groups. First, the **potential entrepreneurs**, those who have the potential to become entrepreneurs but may never actually take the plunge. Second, the **aspiring entrepreneurs**, people who are starting, or have recently started, an enterprise. Finally, the **established entrepreneurs**, existing entrepreneurs who lack skills or knowledge in some respect.

The stimulus to get involved in activities to support SMEs may come from the bank itself or from outside, in which case the bank may become involved at a later stage. This could be during the conception stage but might be after an activity is already up and running. Thus the (primary) responsibility for providing these activities does not necessarily lie with the bank - on many occasions it may play only a (albeit significant) supporting role, the lead being taken by others, such as (local) authorities, trade associations and non-profit organisations. Support can take various forms, ranging from money to manpower.

Although banks' involvement often has no explicit commercial motivation, experience shows that there is a strong correlation between a bank's potential degree of self-interest in an activity and the extent to which it is actually involved. This holds particularly true for target groups which are a little more remote from banks. For instance, banks in Finland, Denmark, Luxembourg and Greece do not provide any specific actions for potential entrepreneurs and little for aspiring entrepreneurs. The reason given is that support for these groups is a matter of public interest and that they are already actively supported by other organisations, such as Chambers of Commerce. The fact that no particular bank feels obliged to take the lead in this area also means that there is no pressure for others to follow.

However, insofar as banks do contribute: What areas do they aim at? What activities do they develop? With whom do they usually co-operate? What are their goals? And what self-interests do they have in doing this?

4.2 DISTINCT TARGET GROUPS

4.2.1 Potential Entrepreneurs

Here the target group is mainly composed of scholars and students. In general, people in this group have not made a definitive choice about shaping their own future. By making people aware of the possibilities and limitations of entrepreneurship, via regular education from a young age, they will be able to make a better-informed choice and work more effectively towards realising it. Moreover, teaching the essentials of good entrepreneurship highlights qualities that are increasingly required in employees too, such as self-confidence, flexibility, the will to achieve, initiative, the ability to spot and take advantage of opportunities and commitment to others.

Banks active in this field are concerned with all types of education, although higher education gets the most attention. The contribution of the banks ranges from offering sponsorship to providing bank employees as tutors at educational institutes. In some Member States, banks (such as the Bank of Ireland and the ING Bank) even finance special chairs in entrepreneurship and banking at universities. The activities which banks undertake to help could-be entrepreneurs have a variety of objectives. In addition to the possibility of positive PR, banks are primarily interested in nurturing a larger future reservoir of potential entrepreneurs and helping to prevent too many people from starting their own company unprepared, with the inevitable consequences. Purely commercial interest plays a part too, albeit indirectly, since co-operation in projects provides opportunities to forge or strengthen bonds with the other partners, including educational institutions, Chambers of Commerce, trade associations and local public authorities. Usually there is more than one goal. The Bank of Ireland, which is heavily involved in projects for schools, universities and students, also wants to contribute to the local community's development with the sponsorship **(see case study 13)**.

The activities in education aim mainly to teach all the basic aspects of entrepreneurship, such as the personal qualities an entrepreneur needs, risk management, marketing, financing, human resource management, networking, etc. This is achieved via specially developed learning material and training by either bank staff or teachers who have taken a course in entrepreneurship.

One of the banking organisations which has developed a lot of educational material in the field of entrepreneurship is the German Savings Bank and Giro Association (DSGV). They even have their own school service unit with extensive material about various specific subjects, enabling them to teach entrepreneurship more effectively. The primary purpose is to enhance understanding of the economic and financial circumstances with which the SME entrepreneur is faced.

It is of great importance that part of the transfer of knowledge to pupils and students involves practitioners. Mediocredito Centrale organises conferences with universities, while Unicaja and the Bank of Ireland organise working lectures for students in co-operation with universities and Business Schools, to which accountants, business consultants and the press may contribute. The lectures address various management subjects and provide the students with an opportunity to discuss the topics covered with the professionals.

Almost all banks who target the potential entrepreneur via education try to ensure that the study material and lessons are as realistic as possible. Simulation Games are therefore very popular. One example is the Business Game 'Startschot' (Starting Shot) developed by CERA Bank in co-operation with the National Association of Christian SME entrepreneurs in Belgium (NCMV). The game, which concentrates on five basic aspects of entrepreneurship (knowledge, the market, policy, money and administration), gives students an insight into the social, commercial and management skills which a small entrepreneur must have at his disposal.

In their quest for realism, the CERA Bank and NCMV go even further in a second school project which requires students to set up and manage an imaginary business. The project has twin objectives: on the one hand, teaching responsibility and entrepreneurial spirit and, on the other, letting students experience the sort of opportunities and difficulties an entrepreneur can encounter. The participants are thus able to compare their theoretical knowledge closely with reality. This is also the case with the mini-companies helped in setting up by the schools co-ordinators from the Bank of Ireland. 'Comhoibriu' ('co-operation' in Gaelic) is designed to raise students' awareness of business and enterprise by applying theory in real situations. Students choose a local amenity service or product as the basis for a job creation scheme. Working in teams of between 3 and 7 people, with direction and guidance from teachers and parents, they collaborate with the local Bank of Ireland branch and other enterprise support agencies to research and present a job creation project suitable for implementation in their local area. The Comhoibriu competition is run in schools and colleges throughout Ireland on a regional basis, culminating in a national final in Dublin.

The business course at Eindhoven University of Technology in The Netherlands has almost entered the realm of virtual reality. A key element is the requirement that students must draw up a business plan based on an idea they have developed themselves. Part of the examination then involves going to a bank to present the "real" plan to an unsuspecting SME account manager in order to obtain financing. The agreement of the banks involved is always obtained beforehand, so their management is fully aware of what is going on and values it because, indirectly, the service offered by their employees to (potential) clients is put to the test. It is perhaps somewhat surprising that, in 1995 and 1996, all 25 teams of two students/pseudo-entrepreneurs, armed with a convincing and realistic business plan, succeeded in getting the required 50,000 ECU from the bank officer to start their (fake) business without having to offer collateral!

Full reality is represented by a training project run by the TSM, an externally-orientated educational institute associated with three Dutch universities. In co-operation with ABN Amro Bank and accountants KPMG, two separate business courses are run periodically - one for students, who can earn study points by taking part, and one to help entrepreneurs brush up their business knowledge. In the course for entrepreneurs, participants are required to produce a new business plan for their own company based on the study material supplied. Every entrepreneur is matched with and assisted by a student who follows the other business course, thus giving each student the chance to work on a business plan that is likely to be put into effect. Students as well as participating entrepreneurs regard this matching as the most useful part of the programme.

In order to make students and scholars enthusiastic about entrepreneurship, various banks, including the Bank of Ireland, Groupe Banques Populaires and the Dutch Rabobank, organise business plan competitions at local, regional and national level. NatWest is involved in a series of business plan competitions, and not only for students **(see case study 14)**. There has even been a European business plan competition for which several banks offered support. Most competitions consist of writing and presenting either a complete business plan or a part of it, like a financial or marketing plan.

4.2.2 Aspiring Entrepreneurs

Banks concern themselves more with aspiring than with potential entrepreneurs. These are people who either want to start their own company or have recently started one, although it can be hard to differentiate one group from another, since there is often a gradual transition between the two. An activity may well start as a hobby or secondary source of income, before developing to the point where it is a financially viable occupation. The ultimate objective of banks is clear: through activities aimed at this target group, they hope to identify good entrepreneurs and attract them as clients. Usually this involves activities whose purpose is to help them increase their level of knowledge and improve their skills.

Banks that are actively involved with start-ups have usually developed special information material, primarily brochures which describe what resources the start-up entrepreneur must have at his disposal, the steps to follow and details of which institutions can be approached for information, advice and (financial) support. Some banks, including NatWest and the Bank of Ireland, have developed several brochures to enable them to address the needs of start-up sub-categories, such as companies with high growth potential and franchisees. The brochures usually include a model business plan that can serve as a frame of reference for the preparation of an entrepreneur's own plan. Even more banks offer this plan on floppy disk which enables the entrepreneur to shape his ideas quickly and simply into concrete form.

Many banks actively search for potential start-ups and organise orientation meetings which tackle various aspects of starting and managing an enterprise. The meetings, which are usually concise and last only a few hours, are often organised in co-operation with other organisations, such as local authorities and Chambers of Commerce. For people who have decided to found their own company, there are seminars about specific subjects and general courses on start-ups which take much more time. Banks are also actively involved in this area - the ING Bank participates in an education programme that is designed for people who want to become franchisees in the food retailing sector **(see case study 15)**.

The organisation of start-up courses is usually left to third parties, the bank's input being limited to sponsorship and supplying teachers to cover the financial topics. Swedbank, on the other hand, does the organisation itself and holds the courses at its local offices. In some countries, such as Belgium, where start-up courses are available on television, banks are also actively involved in selecting and presenting the subjects covered.

Banks are not generally involved in offering intensive guidance for start-ups who are not yet clients. Often, however, they provide this type of support indirectly - for example, various banks give support to organisations that have been set up especially for this task. In Great Britain this holds for, among others, the so-called local enterprise agencies, where several, mainly private, organisations work together in order to help and support (start-up) companies. Apart from money, all large British banks also supply manpower to these organisations via the so-called secondee-system **(see case study 16)**.

In The Netherlands, however, such local enterprise agencies do not exist. For this reason, the ING Bank took the initiative about 15 years ago to establish two independent foundations which give intensive support to start-ups. One foundation, SKB (Foundation for Prospective Businesses), was set up in co-operation with Philips; the other, NION (New Entrepreneurship), with Shell. Both foundations work nationally and serve the same target group: start-ups with good growth prospects. Entrepreneurs belonging to this group get free individual support for a longer period (1 to 2 years). The employees of SKB come from the ING Bank and Philips, those of NION from the ING Bank and Shell. Although they stay on the payroll of their old employer, they can operate independently and, if needed, the staff of both foundations can rely on the support of all founder organisations. However, if the entrepreneur prefers to seek services from other parties, such as a different bank, he is free to do so.

4.2.3 Established Entrepreneurs

Entrepreneurs who have already been running a company for a while generally receive the most attention from the banks, especially those that have a big financing decision to make. Here too, banks try to identify interesting customers through their supporting activities and win them as clients, including young enterprises with very good future prospects. Every year the Groupe Banques Populaires, which is active in the field of education, presents a prize to ten promising young business clients in the form of a participation in the capital of their business ranging from 15,000 to 75,000 ECU. The stake is taken by the group's own seed capital fund, BP Création, and prize-winners can also be granted subordinated loans and grants. Since the scheme's inception in 1973, about 600 enterprises have received prizes totalling some 10 million ECU.

The most important instrument employed when approaching this target group directly is that of organising lectures on specific subjects. To support these meetings, brochures are sometimes produced which go more deeply into the subjects covered. The use of electronic media is now fairly common in this field and some banks give the information on floppy disks, enabling an entrepreneur to analyse his own business situation quickly and easily.

Various banks have separate SME Support units that can help entrepreneurs in a number of areas. Sometimes the service supplied is free, sometimes there are fees to pay. Among the activities that are undertaken: informing entrepreneurs about government subsidies, sometimes in conjunction with doing the paper work required to obtain such funds, and acting as intermediary in finding foreign partners, for instance via the European BC-NET. Much is also done in the field of the European market, an area where the Commercial Bank of Greece, among others, is active **(see case study 17)**.

NatWest has founded a special Innovation and Growth Unit for its promising young enterprises **(see case study 18)**, while the Bank of Ireland supports new and young businesses via its Enterprise Support Unit **(see case study 19)**. The various units usually work with specialised Account Managers (AMs), often co-operating with third parties in order to provide optimal support for the target groups and defray costs. Sometimes the co-operation may assume a more permanent nature for which a separate organisation is set up, normally a (semi-) public body at regional or local level. This is most commonly limited to the support of start-ups, one example being the co-operation between Bank of Ireland and First Step **(see again case study 19)**.

Co-operation can also have a less structural nature and consist of mutual agreements to channel clients with certain requirements to each other - these often exist between accountants, business consultants and Chambers of Commerce. An intermediate form is co-operation on a project basis, such as that between one of ING Bank's offices and an office of IMK (a Dutch non-profit organisation in the field of SME support) whereby the ING office leaves the support of some of its clients in financial crisis to the regional IMK office. These are small enterprises that have some chance of survival but do not merit further attention from the bank, although they are a viable proposition for IMK because of its social function.

One of the problems of co-operation with third parties, however, is not being on the same wavelength. In order to avoid this problem, the Bank of Ireland and some German Savings Banks have re-employed former staff, such as retired branch managers, to help support the start-ups which they finance. Analogous to the American banks' SCORE programme (Service Corps Of Retired Executives), they act as mentors to these businesses and organise discussion evenings for small groups of young entrepreneurs.

One bank activity that aims especially at young, dynamic enterprises is participation in so-called incubator centres. This normally involves housing several enterprises under one roof and allowing them to share central services and facilities. These centres can focus on young enterprises in general or on specific target groups like high-tech enterprises, environmental firms, food processing businesses, etc. A variation on the incubator centres are the Science Parks, where companies are not under the same roof, but on an industrial estate specially developed for that purpose. These Science Parks usually have strong ties with a nearby university or research institute. One example is Tech-Invest, an initiative in which the Volksbank in Salzburg (Austria) is strongly involved **(see case study 20)**.

An important strength of incubator centres and Science Parks is their capacity to facilitate the exchange of knowledge and information between the entrepreneurs established there. This is particularly important for most SMEs, especially in the first stage of their existence. Networking like this can be done in other ways too. In order to help companies to extend their network and use it effectively, Bikuben Bank organises so-called after-work meetings in co-operation with an accountant, while other banks incorporate short lectures into similar meetings, in order to attract as many entrepreneurs as possible.

Finally, many banks supply sector information to both clients and non-clients. The German Savings Banks have their own 'Branchendienst' (Sector Information Service) with topical information on relevant sectors of trade and industry. The Rabobank in The Netherlands produces an annual publication with figures and trends for a large number of sectors, while the Rabobank supplies this information free to everyone who is seriously interested in it.

Sometimes the information that banks work with is bought from specialised companies, sometimes they collect it themselves. Most banks have their own research units which carry out research partly to support their own policy and partly for publications. In the latter case, the results can lead to new (government) policy and hence to an increase in the quality of entrepreneurship. One bank that publishes a lot of material in order to support Italian companies is Mediocreditio Centrale, which has a very well-equipped SME Monitoring Unit in Rome and a Representative Office in Brussels to help disseminate the results of its research.

The supply of information, advice and other types of support is still done mostly via face-to-face contact between bank officer and client. However, the use of multimedia applications makes such support accessible to a wider public and a number of banks, including the Dutch Postbank, have already started to develop this promising approach to helping clients **(see case study 21)**.

5. Reshaping the organisation

Much of the criticism emanating from SMEs is aimed not at the banks' products or the conditions under which they are offered, but at the nature, quantity and quality of the service which accompanies them. All these aspects are interrelated and are shaped by a bank's organisational structure.

Various research studies have shown that transparency is a top priority for SMEs, not just as regards cost structures, but also in the procedures followed (i.e. "Why has my request for credit been refused?") and in the way complaints are settled. Entrepreneurs want to have a clear understanding of how the bank is dealing with their affairs. A second priority concerns client service - SMEs want their banking services to be delivered in a simpler, more accessible, more effective way, including availability of services outside normal business hours.

Additional pressure on bank organisations comes from their own management. Higher revenues are now expected to come less from market growth than from truly customer-orientated organisation, creating an environment in which there is more cross-selling and fewer bad debts, where staff have a better knowledge of what SMEs want and where fewer good customers change bank unexpectedly. The desire to maximise revenues is mirrored by a need to reduce the costs of staff, credit handling and transaction processing. These are all areas in which there have been substantial cost increases in recent years, especially labour costs, where banking has often surpassed all other sectors.

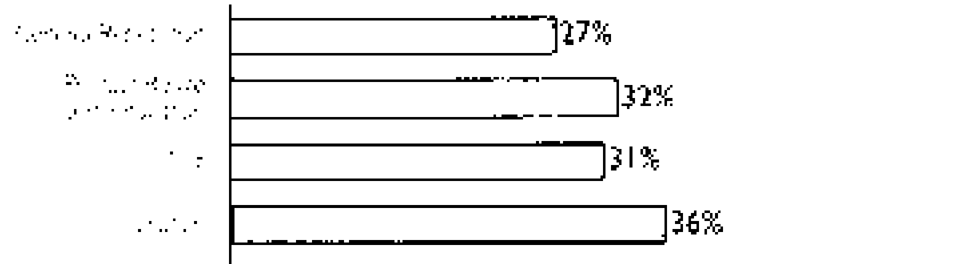
Costs relating to screening and granting credit have risen for a number of reasons. Firstly, problems in obtaining relevant information about the entrepreneur and his business have arisen because both have become more mobile and dynamic, making them more difficult to identify. Secondly, there is now greater legal protection of clients and their assets. Finally, costs have resulted from the introduction of new IT equipment without adequate adjustments to the banks' organisational structures.

Thus, as far as organisation of banks is concerned, their interests and those of SMEs are certainly not identical and, at first glance, seem to conflict. How, therefore, do banks develop structures which better serve the interests of both parties? In fact, different banks in different countries choose different responses. What are the differences? And how does the choice affect the solution of the common problems which face almost all banks dealing with SMEs?

5.1 THE PRESENT DELIVERY ARCHITECTURE

Banks dealing with SMEs can be roughly divided into three main categories: co-operative banks, savings banks and commercial banks. Although, in the past, they were all

Diagram 7: Reasons for Choosing a Primary Bank



Source: PSI, Inc.; IBM Consulting Group.

strongly specialised, each having its own target group, over time they have converged, both in their working methods and the markets they serve. Nowadays, all the banks focus on SMEs. In northern Europe the blurring of sectors took place in the 1960s and 1970s whereas, in the southern European countries, the process started in the 1980s and 1990s as a result of globalisation and European integration. Even so, the organisational structures of banks still differ widely, both as regards their legal framework and their allocation of authority.

5.1.1 The Distribution Channels

Despite the (continuing) differences in organisational structures, particular working methods and distribution channels are not confined to specific types of banks, although this does not imply that they all work in the same way. Variations are especially noticeable in the field of distribution, some banks having only one channel, while others use more.

Branch offices still represent the most important distribution channel for all banks dealing with SMEs. Since the number of local banking outlets is relatively large, almost all EU Member States have a dense network of bank offices. To put this in perspective, figures for 1992 show that the density of bank offices in the EU was four times that in Japan. While this network helps in delivering services, the reverse side of the coin is the costs involved. The general policy of European banks is to reduce the number of their branch offices, partly because research (such as that illustrated in diagram 7) shows that location of the bank office is no longer the client's key concern. However, the number of local outlets is still growing in countries such as Greece and Italy.

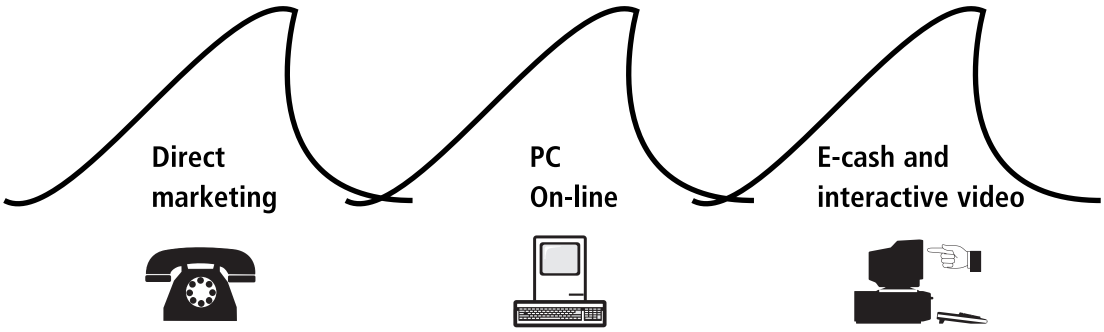
a) Relationship Banking

Contact with clients in so-called **relationship banking** can be maintained by an Account Manager (AM) who has full responsibility for the banking affairs of a defined portfolio of clients. This makes the AM different from other sales officers within the bank, who have no long term relationship with a group of clients and tend to specialise in one or more products. The question of whether someone is an SME account manager or not obviously depends on the definition of an SME which the bank applies and on the extent to which the AM has a homogeneous client portfolio. The reality is that an AM's role can vary. Some banks use AMs only for limited target groups, partly because a number of banks have only recently switched to the account management approach and only on an experimental basis. As regards banks which have been using AMs for a long time across the whole organisation, a distinction can be made between differentiated and non-differentiated AMs. With a differentiated approach, AMs concentrate on a specific segment of the market, i.e. SMEs, or focus even more narrowly, i.e. on start-ups or High Value Clients. With a non-differentiated approach, on the other hand, there is no distinction and the AM has both large and small companies in their portfolio.

b) Virtual Banking

Virtual banking is characterised by the absence of face-to-face contact between the client and the bank's staff - instead, transactions are handled directly between the client (wherever he is) and a central unit within the bank. Virtual banking started a long time ago with the use of post and telephone for transactions and, since then, new media have been introduced. The development of virtual banking can be roughly divided into three technological waves (see diagram 8), all of which are still expanding their activities. Advantages for the client are the relative ease, speed and low cost with which he can access services. However, not all the waves were equally successful in the beginning. In particular, the introduction of PC on-line, some 5 to 10 years ago, had a false start. One reason was banks' decision not to treat electronic banking as an alternative distribution channel, but as a special product which should be sold only to the top end of the SME market. However, helped by the arrival of new information technologies and more user-friendly interfaces, banks have recently started to develop electronic banking as an addition to existing distribution channels. A separate organisational structure, with its own administration, targets, products and customer support (such as a telephone help desk), should help it to expand and generate some of the sales which were previously

Diagram 8: The Three Waves in Virtual Banking



	Direct marketing	PC On-line	E-cash and interactive video
Assumptions	• Wide acceptance of: – telephone – ATM • Wide availability of electronic instruments of payment and of clearing networks: – credit cards – debit cards	• Most important SME clients use PC on-line • Financial Management Software/Electronic Gateways are becoming popular • Internet, gateways and Intelligent agents promote electronic selling	• E-cash and smartcards replace substantial part of cash transactions • Real time video will grow: video phoning, interactive TV, etc.
Benefit to clients	• Access/Ease	• Information, control over finance	• Services with additional value

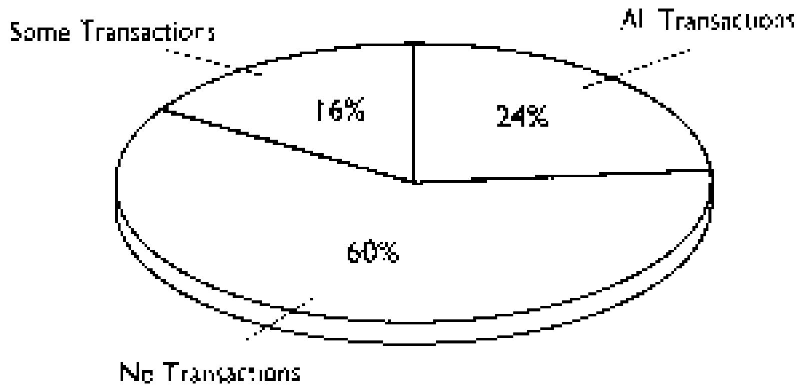
Source: McKinsey & Company/Dutch Postbank, 1996

derived from bank branches. Banks have high expectations of this medium. Research by Deutsche Bank shows that 15% of clients are prepared to switch to virtual banking and, for this reason, it has recently announced an experiment with money transfer via Internet[5]. This new technique, used since 1995 by the American Mark Twain Bank[6], will also soon be introduced by banks in Finland and Sweden.

Another method of virtual banking is telephone banking, a distribution concept whose development is backed up by research which shows an increased willingness on the part of clients to use the telephone. The exact nature of telephone banking differs between banks, ranging from voice response systems or screen phones to fully staffed call centres that are open 24 hours a day, 7 days a week. Large banks in Great Britain have been using telephone banking since 1994 and there is now discussion of introducing this rapidly in Germany. The Postbank, a division of the ING Bank, is heavily committed to telephone banking, serving about 176,000 clients from a central call centre with 16 operators in Amsterdam. A neural network system assesses

[5] Internet address: http://www.deutsche-bank.de/akt_mitt/pi080596.htm
[6] Internet address: http://www.marktwain.com/

Diagram 9: Companies Willing to Use Electronic Banking



every client on the basis of 125 selection criteria, provides independent verification of credit scores and, using these results, automatically and proactively offers loans to clients without human intervention **(see case study 22)**. This contrasts with the situation in most European countries, however, where advanced telephone banking is still in its infancy. Although this type of banking offers several big advantages to clients, such as easy access and convenience, the question remains as to whether it delivers the predicted cost reductions. Staffing call centres on a permanent basis is expensive and operators and/or telephone account managers need special training. Furthermore, setting up the systems requires large and ongoing investments in advanced technology and know-how.

It is reasonable to assume that the significance of virtual banking, as a separate distribution channel alongside relationship banking, will increase even more in the future. Research in countries where the new forms of virtual banking have been introduced shows a high level of client satisfaction, coupled with considerable growth potential in the SME market (see diagram 9). A number of banks and institutions, including the Dutch Postbank, already offer their expertise in this field to other (foreign) banks, thus helping to ensure that it will be used increasingly for all target groups and all financial services. Some banks believe that virtual banking makes clients "shop around" to find the best deal on price (especially since products and service from virtual bankers will be more or less the same), putting pressure on margins in the long run. Most criticism, however, is directed against the ultimate use of neural network systems, the proactive loan offers they make and the fact that they represent the transfer of decision-making from people to machines. The absence of cautionary advice from bank specialists could lead to flawed investment decisions by entrepreneurs and some banks fear financial disasters resulting from computerised systems operating without restraint.

c) Partnership Banking

A large number of banks still make use of a third distribution channel, namely intermediaries who, paid or unpaid, cooperate in the sale of banking products on a win-win basis. Advantages to the banks of this system are spreading their costs, the chance to tap quickly and easily into additional target groups and the possibility to employ other means. The nature and intensity of this so-called **partnership banking** varies considerably. In this domain, the ING Bank operates a franchise formula under a different label: the Regiobank (formerly NMS Bank), whose 500 agents are established in areas where an ING Banking office would be unprofitable. Other banks, including the Belgian CERA Bank, make use of agencies for the sale of a number of specific products. These agents can limit their activities to selling exclusively banking products, or they can conduct secondary activities, such as accounting offices, insurance agencies and real estate agents, which bring them into contact with the same target group. The co-operation can also be of a much looser nature. This is the case, for instance, for co-operation between banks and local organisations for the development and sale of financial products to start-ups and to young, growing enterprises (see the local loan funds in Great Britain, mentioned on p.19) or to ecological enterprises.

The most common form of co-operation is individual or where the organisation involved has no sales responsibility but merely supports this activity, albeit on a non-exclusive basis; in other words, entrepreneurs with whom one comes into contact professionally are directed to a certain bank to obtain financing for their plans or for other financial services. In most northern Member States the accountant is the most important intermediary between banks and SME entrepreneurs. This results from the close relationship between accountants and large parts of the SME sector. In the southern Member States, however, where this relationship is less close and extensive, the role of the accountant as intermediary is commensurately reduced. It is not just accountants who fulfil the role of intermediary - business advisors, brokers, Chambers of Commerce, regional development agencies and local authorities can also act as a link between bank and entrepreneur.

Partnership banking will also increase in importance in the near future. This is closely related to the fact that banks are acquiring new distribution channels via mergers, take-overs and far-reaching arrangements. Insofar as national regulations permit this, it is also possible to sell banking products through this new network. Recently, the Dutch Postbank has made an agreement with MKB Nederland, the Dutch SME organisation, to sell smart cards through their member/trade organisations. Besides domestic banks, other parties are interested in non-banking network organisations with the ability to sell banking products - for example, foreign banks that cannot or do not want to have a second branch network, or strong and well-capitalised non-banking organisations that want to sell banking products without being subject to banking regulations.

5.2 CHALLENGES TO BANKS

Research into the way in which SMEs are served by banks brings a number of notable facts to light. Firstly, there are large differences in profitability between the banks, with profits in the SME portfolio ranging from around 0 to over 15 percent. This situation is mainly due to variations in the efficiency with which credit is granted, the most profitable banks having introduced a very streamlined underwriting process. More important than the profitability of the product 'credits' is the conclusion that, when comparing the various banks, profits are not divided uniformly over the total SME portfolio. In fact, a relatively small percentage of the SME clients are responsible for the greatest part of the profit. Put another way: the remaining clients yield little profit. To the extent that some produce losses, cross-subsidising takes place in two ways. On the one hand, from profitable SME clients to those which produce losses; and, on the other hand, from profitable to unprofitable products, usually from profits on deposits and money transfers to losses on loans. The reason that these issues have only recently been brought to light is the fact that competition is getting fiercer and banks are being forced to analyse their costs and income in much greater detail. Moreover, banks with new, advanced IT applications are better equipped to calculate the profit per client, per product and per market (sub)segment than before.

There is often talk of an unequal division of profits in other banking segments as well. Solving the problem in respect of SME clients, however, is urgent because the percentage of High Value Clients is decreasing rather than increasing. The skewness problem in the SME sector is also not necessary. For example, as opposed to the "large corporate" market segment, profit margins are under less pressure from external factors that are difficult to influence. In general, SMEs are loyal to their bank and willing to pay a good price for good service. Raising prices for unprofitable products and client groups or transferring purchasers to other, cheaper distribution channels brings comfort to only a very limited extent. This is even more true in the light of research which shows clearly that a considerable proportion of SME clients are not absolutely satisfied with their bank. Criticism centres on supposedly excessive bureaucracy and is especially strong from clients of centrally controlled banks with a rigid, hierarchical structure. Other points of criticism are the moderate price/quality relationship, lack of transparency in procedures and when determining tariffs, and the quality of bank staff. On the last point, criticism is mainly levelled at their lack of dedication, authority, skills and know-how.

5.3 BETTER PRACTICES IN SEGMENTATION AND ORGANISATION

In the past - when markets were growing - much attention was given to finding optimal product/market combinations. Under present circumstances, however, where banking margins are under pressure and clients make greater demands on bank services, internal re-organisation and streamlining are more important. What, in this domain, are the banks' 'better practices'? The emphasis here is on relationship banking, since this will remain the most important type of banking for SMEs. In fact, this is the area most criticised by entrepreneurs on the one hand, and where banks experience the greatest problems in maintaining their margins on the other. Finally, it is significant that banks want to improve their relationship with SMEs. More and better contact should inevitably help to minimise the incidence of bad debts, reduce the tendency of clients to change their bank and create more cross-selling opportunities.

5.3.1 Improving SME segmentation

The problem for many banks is not a lack of good SME clients, but rather that too many of their clients do not receive optimal service, thus leading to dissatisfaction and/or lower than desired revenues. This is illustrated by the previously mentioned skewing of the SME market segment, whereby a small part of the client portfolio generates the vast majority of the profit. Simply getting rid of SME clients who yield little or no profit would be a radical solution, but certainly not an effective one for the banks. Apart from the fact that they need most of these clients in order to achieve their required sales volume, practice shows that there are realistic options which satisfy both client and bank.

The key to the solution lies in good segmentation of the total SME portfolio, making it easier to use available resources in the right way and in the right measure. This applies particularly to the various distribution channels, information technologies and sales officers. The Bank of Ireland, for instance, has two types of SME Account Manager: District Enterprise Advisers for existing and new small entrepreneurs, and Area Account Managers for larger SMEs. NatWest has three types of Account Managers. Segmentation can be done in two ways. First, through a value-based approach which matches delivery cost to customer value by examining (for every client) the profit on the main banking products. Using this approach, Groupe Banques Populaires has identified the following SME segments: upper, middle and lower, each divided further into existing and new enterprises. The second method of segmentation, "splitting", is based on the needs of the client - for example, the size and nature of the enterprise (the criteria used by CERA Bank). The two methods of segmentation should not be considered mutually exclusive - on the contrary, in the quest to reach a balance between optimal profit and optimal support for the client, they are very much complementary. Thus most European banks use both methods, albeit not always within a well-weighted segmentation policy.

Segmentation is certainly not easy, especially if the preferences of both banks and customers are taken into consideration. Diagram 10 shows the results of a study carried out by the Business Banking Board. This illustrates that it is not the customers with a high contribution to the bank's profit who prefer working with a branch office and an account manager, but the (from the banks' point of view) low value or loss-making clients. In fact, the top clients (according to this research) prefer telephone and PC-banking! Even though banks now have access to better assessment methods, backed up by advanced IT systems, decisions are still based largely on subjective criteria. In fact, not everyone within the bank will agree with the chosen starting points, which begs the question of who will actually undertake the classification of clients and whether these classifications will be respected. Moreover, a decision must be taken as to

Diagram 10: Segmentation based on of Clients' Behaviour

Professionally Managed	Up and Comers	Made-Its	Start-Ups	Perfectionists	Traditionalists
Characteristics					
• Established firms • Multiple financial providers • Not willing to use bank as advisor • High credit usage • Not willing to mix personal and business • Use brokers for investments	• Fast growing • Driven by credit availability • Willing to use bank as advisor • High credit usage • Willing to consolidate business and personal • Not currently using banks for investments	• Established firms • Willing to receive advice but not pay for it • Fairly high credit usage • Willing to consolidate personal deposits but not investments	• New, growing firms • Desire advisory services • Willing to consolidate business and personal • Prefer dedicated small business office	• 39% borrow • Need advice but not attached to RMs • High consolidation of business and personal • Low investments and benefit plans	• Established firms • Multiple providers (bank is secondary provider) • No desire for advisory services • Low credit usage • Not willing to consolidate business and personal • Highly branch dependent
Profitability					
Highly Profitable • 6% of customer base • 28% of revenues	Moderately Profitable • 9% of customers • 29% of revenues	Moderate/Low Profitability • 15% of customer base • 11% of revenues	Low/Negative Profitability • 24% of customer base • 10% of revenues	Low/Negative Profitability • 16% of customer base • 6% of revenues	Negative Profitability • 30% of customers • 16% of revenues
Channel Preference					
Telephone/PC	Relationship Managers	Branch	Dedicated Small Business Office/ Relationship Manager	High-Tech (require primarily quick access low price)	Branch

Source: Minos Bank.

whether very profitable and (only) relatively profitable clients will be treated in the same way. However, the main principle should be that the customer decides by whom or what systems he wants to be served. Within this framework, the bank must consider how best to meet his needs, taking into account his contribution to the bank. Diagram 11, from Oliver, Wyman & Company shows one approach to this issue.

There are also numerous practical problems, such as: does segmentation also make sense for small, independent, local banks in view of their small business portfolio? What should a bank do when its resources are limited and its options restricted, for instance, when it has only one distribution channel? What do you do with clients who yield little profit? Can a client who fails to reach minimum profitability thresholds be moved down a tier or offered a different level of service? In fact, it is impossible to give an unambiguous answer to these questions and to define a uniform segmentation policy. Many banks have still not reached the point where they have an accurate idea of the profit per client - in Belgium, for example, the CERA Bank uses a simulation model for client profit which puts it ahead of many of its (larger) rivals. Thus the best practices described below should not be considered exhaustive.

The following analysis describes SMEs as falling into various profit categories, some of which (e.g. 'Low Value' and 'Deficit Value' SMEs) may appear to the uninitiated reader to imply a value judgement. This is not intended. Whilst SMEs

Diagram 11: Matching Delivery Preferences from Bank and Client

Segment	*Delivery/Service Preferences*	*Contribution*	*Delivery Decision*
Professionally Managed (6%)	Telephone/PC	High	High-Tech Channels
Up and Comers (9%)	Relationship Manager	Moderate	Relationship Managed
Made-Its (15%)	Branch Dependent	Moderate/Low	Branch Serviced
Start-Ups (24%)	Dedicaded Small Business Office/ Relationship Manager	Low/Negative	Branch Serviced (Cross-Sell Aggressively)
Perfectionists (16%)	Convenience/ Low Price	Low/Negative	High-Tech Channels
Traditionalists (16%)	Branch	Negative	Branch Serviced (reprise Aggressively)

Source: Oliver, Wynan & Company.

certainly do not think of themselves in these terms, it is useful for them to be aware that banks do and that they draw certain conclusions as a result. Indeed, SMEs should take this into account in their relationship with their bank.

a) High Value SMEs

Every bank client wants good service for his money but banks usually take particular care of their High Value SMEs and have a special policy for them. This group of clients is referred to by various names: Premium Clients (NatWest), Prestige Clients (Caixa Geral de Depósitos), Hot Clients (ING Bank) or Blue Chips (Deutsche Sparkassen). They receive special attention not only for relationship banking, but also for virtual banking, where the impersonal nature of the medium means it is important to develop stronger ties with these clients at a personal level. For ING Bank's direct banking channel, 1% of the clients, generating 20% of the profits, fall into this category.

The Account Manager (AM) is still the most important policy instrument for this upper group. Firstly, because most banks assume that their best clients appreciate close, personal attention and are willing to pay for this. An AM, however, also has a valuable commercial function to perform as well, so considerable demands are made on AMs who deal with this particular group of SMEs. Since it is essential that he is accepted by the customer as someone with whom he can talk easily, he needs to have extensive knowledge, experience, contacts and influence, as well as being able to speak the language of the entrepreneur. For this reason, some banks, including the Banque Générale du Luxembourg S.A., look closely at the entrepreneurial background of potential new AMs before they recruit them - if they, or their family, have experience of running businesses, this gives them an advantage. It is also desirable if AMs can carry a lot of responsibility, are accessible to their clients 24 hours a day and have the ability to find innovative financial solutions to latent problems.

To complement the role played by the AM, a bank's management also needs to pay special attention to High Value SMEs. This will include guidance and support for the AM, appointing shadow AMs to cover in case the primary AM is not available and implementing a customer loyalty programme. The latter involves inviting customers to dinners and sports or cultural events. For example, Caixa Geral de Depósitos has incorporated a large, public theatre into its head office - this hosts world class drama and music productions to which offices of the bank can invite their best clients. This is just one way in which High Value SME clients are looked after by the bank - they also receive other preferential treatment **(see case study 23)**.

In general, it appears that southern European banks cosset their top clients rather more than their northern European counterparts, partly because, in the absence of lasting relationships with banks, southern European entrepreneurs are inclined to change bank more often. The approach adopted by the Commercial Bank of Greece illustrates how High Value SMEs are treated. The bank's best clients are visited usually once a month by the local director, sometimes in the company of an expert. The visit may be to discuss purely banking matters, or it may cover more wide-ranging topics.

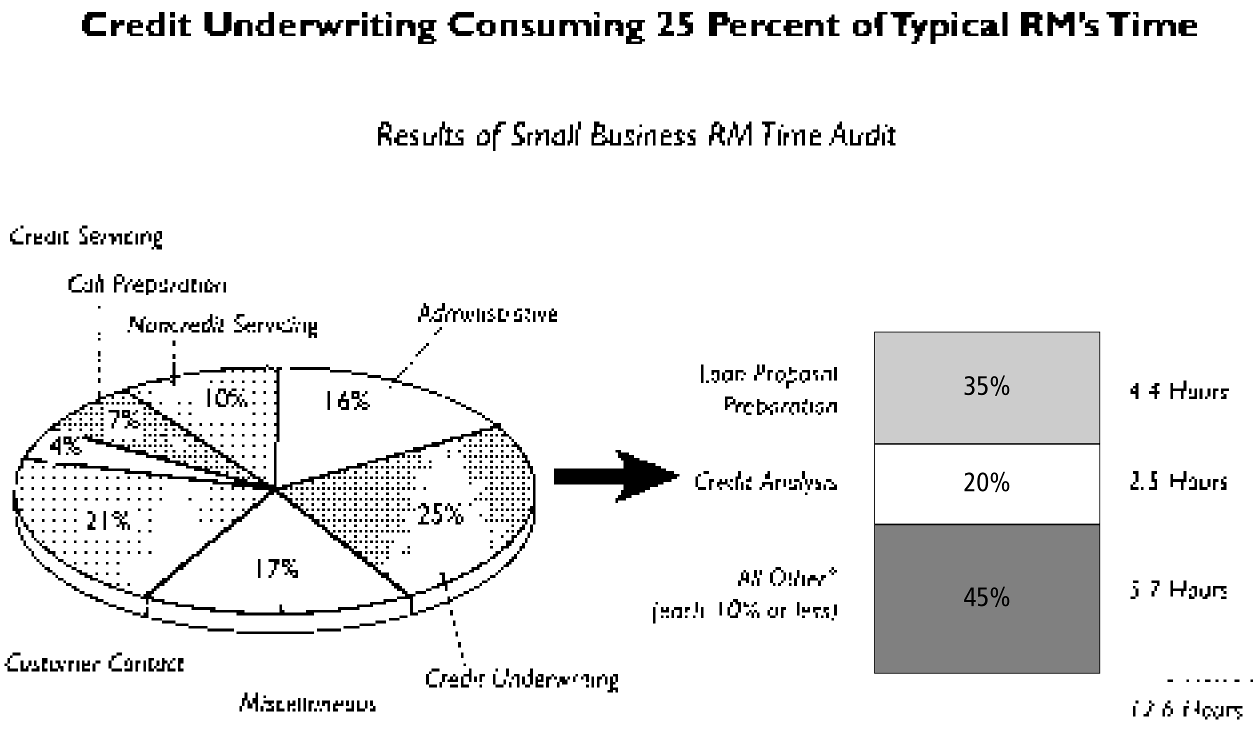
The Commercial Bank of Greece provides its clients with expertise and information about their business sector as well as on funding from national and Community sources. The client is always at the centre of such a policy, even if this means the bank discloses information which, in the short term, may cost it money, such as advice on how to obtain cheaper loans. Entrepreneurs are also rewarded with lower prices for products and services if their behaviour is good. Finally, the bank maintains frequent contact not only with the entrepreneur, but also with the environment in which he operates - his staff, suppliers and large customers, all of whom can provide information which is useful to the bank in its direct contact with the entrepreneur himself.

As for all SME segments, one of the most frequently recurring problems is a failure to spend sufficient time nurturing the relationship. Research undertaken by the Business Banking Board shows that the average account manager spends only 21 percent of his time in real face-to-face contact with his clients (diagram 12). There are several reasons for this, of which one of the most important is assigning too many clients to individual AMs. Banks with a well-balanced policy limit the maximum number of clients per AM in the High Value segment to between 30 and 50 and arrange the back office functions in a way which allows the AM to spend as much time as possible with clients. However, the AM himself can also cause problems for himself by getting his priorities wrong, especially when it comes to allocating time between high and lower value clients - it is a fact that the lower value clients tend to want attention more quickly and more often than high value clients.

A second problem concerns the quality of the relationship. Since the AM is the lifeline between the bank and the High Value SMEs, any disturbance to this relationship can have serious negative consequences. Problems can also result from the bank's own policies, perhaps because of a bonus system which leads AMs to set their priorities wrongly. Thus more and more banks are giving AMs quantified targets per client which must be achieved within a given time period. Some banks, including Caixa Geral de Depósitos and Banque Générale du Luxembourg, have actually changed to managing their High Value SME clients centrally, as they already do for their large corporate clients.

A potentially serious threat, latent until recently, is **banks' liability**. Since maintaining intensive, far-reaching relationships means that promises may be made or advice given which ultimately have negative consequences for the entrepreneur, there is an increasing fear that entrepreneurs may resort to legal action to obtain compensation. Banks could be especially vulnerable where the dispute involves the one-to-one relationship between the client and the AM, so it is crucial that AMs can be relied on. There do, in fact, appear to be a number of problems in this field, such as client port-

Diagram 12: Time Allocation of a typical SME Account Manager



Source: Business Banking Board, Composite Work Flow Audit Results from Member Bank, (1993):4.

folios which are too large and lack of authority to make decisions. It is also important that AMs are allowed to manage a particular portfolio for a number of years, so that a strong relationship with the entrepreneur can be established.

b) Medium Value SMEs

A second category of enterprises which receives a lot of attention from many banks is Prospective SMEs, i.e. the group of Medium Value Clients which, with time and effort from the bank, can become High Value Clients. This group can also be most effectively developed by using AMs, although the number of clients per AM tends to be higher than for High Value Clients. The CERA Bank has developed a policy of intensive support which is implemented by AMs, each of whom takes care of about 60 SME clients, with the intention of developing them into High Value Clients **(see case study 24)**.

Banks such as CERA Bank, which have developed a specific policy for this market segment, often recruit AMs from among bank employees who are themselves considered to be of high potential. The time they spend in the role of AM for Prospective SMEs is an important intermediate stage in their careers. One result is a fairly high rate of staff turnover, although it should be pointed out that a number of banks strive to ensure that job rotation takes place only every four to five years in order to help guarantee the objectivity and profitability of the relationship with the client.

One characteristic of Prospective SME clients is that they tend to be very dynamic which, of course, has consequences for their financial needs. To deal properly with this problem, the AM can rely on internal bank specialists and on the information which has been collected on the clients in question. He himself plays an important role in updating this information, since the clients have to be intensively and individually monitored in order to give them the best chance of becoming High Value Clients as soon as possible. One challenge is to ensure that they do not move to other (non-bank) suppliers for (project) financing, such as factoring companies and finance houses, so it is essential that AMs have a full understanding of all the products that the bank offers. In order to help maximise its income in this respect, NatWest started a pilot project called "Connect" whose aim is to enhance cross-sector working within the NatWest Group.

Prospective SMEs want an AM who has a good level of authority and who can deal quickly with their requests for financing. In order to meet this demand, some banks, like the German Savings Banks, have equipped their AMs with Advanced Decision Support Systems. This said, European banks in general have not yet gone as far as some of their American counterparts, where the financing decision is left entirely to the computer. The AM always has the final say in the matter, drawing on his own knowledge and personal impression of the client.

The demands on AMs who are responsible for Prospective SMEs, although substantial, are less far-reaching than on those responsible for High Value SMEs. They must be able to establish a good personal rapport with their clients, network effectively both inside and outside the bank, have a reasonable knowledge of the bank's products and be good organisers. Several banks run seminars on specialist subjects for small groups of pre-selected entrepreneurs, where the AM is responsible for identifying appropriate subjects, selecting potentially interested clients and inviting experts. In addition, he has to make sure that representatives of the bank's top management attend such events from time to time, since Prospective SMEs are normally keen to make high level contacts. It goes without saying that target-based planning is an essential element in a good strategy for Prospective SMEs.

c) Low Value SMEs

The third SME market segment consists of Low Value SMEs, which constitute the vast majority of SMEs. The greater part of these enterprises offer at present little or no direct potential for banks, since they generally have few ambitions to expand and grow. These clients represent the greatest challenge for banks, partly because of their minimal contribution to banks' profits, partly because of the relatively high demands they make on the banks' services, and partly because they can contribute in an indirect way to the profit of the banks: firstly, through their contribution to fixed costs and, secondly, through their influence on other areas of banking. A good example is SMEs in the retail sector - the introduction of the new Electronic Wallets or Smart Cards in Europe means that they become very important. Banks with no or limited access to the retail sector lose out in this new area.

Many banks use AMs, working face-to-face with clients, in this market segment as well and an AM can typically have around 100 clients to deal with. This leaves some doubt as to whether it is possible for the AM to give sufficient time and attention to each client and whether the arrangement can be profitable. To address this issue, some banks are currently experimenting with central servicing using, for instance, a Multi-Media AM. One side-effect is that relationship banking moves closer to virtual banking with telephone AMs, albeit for a different target group and purpose, namely the Prospective SMEs which banks do not want to lose to other, cheaper virtual bankers. This enables AMs to concentrate either on clients who are financially risky or on those who have the potential to move to a higher market segment.

The gap which opens up as a result of using remote AMs can be filled by supplying the clients with comprehensive supporting material - this may not only be brochures about banking products and enterprise management, but also magazines and even software. NatWest gives its clients business planning disks which make use of Microsoft Office applications. As described previously, the Dutch Postbank, the direct banking channel of ING Bank, has developed an integrated support package for this reason **(see again case study 21)**. In addition, large meetings can be arranged for the target group to help develop personal contact. Whatever the policy, a good database and effective control from the central marketing department is necessary.

d) Loss-making SMEs (for banks)

Finally, there are the Loss-making SMEs, enterprises to which banks nevertheless commit a lot of time for relationship management. They are often at a precarious point in their life-cycle and require intensive involvement from the bank only on a temporary basis. Such enterprises vary considerably in nature, from young innovative companies which could be on the way to becoming High Value Clients (but could just as easily fail), through marginal start-ups that receive special treatment for reasons of PR or government pressure, to debt-laden businesses where the bank would lose more by cutting their credit lines than by supporting them. At the Bank of Ireland this is done by the Accounting Service Department, a small, elite, professionally staffed unit which deals with SME lending, reconstructions, mix of finance, etc. It is particularly focused on dealing with SME problems in times of crisis and has a very successful record in saving companies that otherwise, in the traditional way of handling enterprises in an emergency, would have gone out of business.

5.3.2 Restructuring the branch network

One of the thorniest, most frequently recurring problems in banking organisation is bureaucracy. Increasing scale-enlargement as a result of mergers and take-overs, compounded by earlier, incomplete reorganisations within banks, poses constant challenges. In response to this, many head offices have put in place systems to facilitate monitoring and control of their branches. In the past, this function used to be performed by the various departments but is increasingly carried out from a central point in the head office. At the same time, more authority and responsibility are being decentralised, including decisions which relate to SME clients. Thus the head office is moving more and more towards a supporting, rather than a directing, role.

In order to remove bureaucracy from the entire organisation in one blow and to prevent it from regaining the upper hand, the CERA Bank has carried out a comprehensive plan. The entire organisation, from head office to local branches, was analysed in order to identify overlaps, obstructions, unnecessary and excessively long procedures, lack of necessary co-operation, etc. A coherent plan was then drawn up and put into action after deliberation with and approval from all the co-ordination groups. These groups consisted of officers from all departments within the bank that have a say in the overall approach to a market group or market segment. Finally, the credit approval committee was reorganised. The officers were given a higher signing authority and, for some local banks, the committee's membership was changed to include the branch office manager, his SME account manager and a travelling SME advisor from the head office. The interest of the client was always the central element of the plan. After the plan was implemented, he could be reasonably sure that credit requests processed by the local credit approval committees would be answered within 72 hours, that possible complaints would be dealt with within 48 hours and that the services he received would meet high quality thresholds.

The Groupe Banques Populaires launched a plan in 1990 that went beyond the abolition of bureaucracy, aiming also to increase the productivity of the sales organisation. A test project was started, in which six associated regional banks participated. The existing situation was analysed and quantified in six specific fields of interest. These results were used to develop an auto-diagnostic instrument that was placed at the disposal of all the associated banks, together with a list of all the good practices which had been identified **(see case study 25)**. The banks could then decide for themselves to what extent they wished to make use of the information and techniques offered.

In order to enhance their commercial effectiveness, more banks, both centralised and decentralised, are separating their front and back office functions. This involves removing routine, administrative activities (back office) from local offices and accommodating them in central, specialised and highly automated centres, leaving local offices to concentrate on sales activities (front office). As a centrally organised bank, the ING Bank has recently developed such a policy for its entire organisation. The heart of this so-called Operations Project is the introduction of strict separation between commercial and operational functions in all offices. Sales will take place from the commercial units, while administrative settlement is looked after exclusively by the operational units.

To become more flexible and effective, the Deutsche Bank has started to open full-service branch offices in big shopping centres. These offices will be open as long as the shopping centres in which they are located, which means six and sometimes seven days a week from early until late. The Deutsche Bank expects that these branches will, in the future, offer the same services as direct banks as a result of the liberalisation of German laws on shopping hours.

5.3.3 Developing a multi-distribution strategy

Despite the fact that banks want to maintain and, if possible, extend their market share among SMEs, most of them are considering a further reduction in the number of their branches. The general view is that a more efficient and effective organisational structure should be the source of the additional capacity required. Insofar as expansion of the sales channel is considered necessary, it seems a number of banks are investing primarily in the area of virtual banking.

However, other alternatives are available. Mergers between banks and insurance companies have created completely new distribution possibilities. Banking offices can thus enhance their product package for SMEs with special SME insurance products, while the insurance agents who are associated with the new banking/insurance group can henceforth supply banking products to their business clients. Apart from providing more opportunities to tap into the SME market segment, this strategy can also lead to a decrease in costs as a result of scale enlargement. However, financial institutions that have started down this road, such as the ING Bank and the Belgian Almanij-Kredietbank, have encountered some problems that will need to be addressed in the future. These include how to deal with internal competition between the various distribution channels and how to attune the different working methods of bankers and insurance agents to each other.

The Italian bank Mediocredito Centrale, which has recently become a joint-stock company and which has no branch network, tries to effect some of its sales by engaging small, independent, locally-orientated banks in its sales activities. In contrast to Mediocredito Centrale, these banks (as a result of past banking legislation) have little or no experience in offering long term loans to SMEs. Co-operation with Mediocredito Centrale gives them a better chance of staying independent.

Exploiting other banks' networks appears to be a strategy which can be applied to international expansion as well. In order to be able to keep providing domestic SME clients (who are internationalising themselves) with the required financial means, some banks co-operate with foreign banks in order jointly to finance the enterprises in question (such as franchise organisations). For instance, the ING Bank recently signed contracts with several European banks in which the parties agree to give each other financial guarantees (to a certain maximum) for domestic clients who wish to invest abroad and who apply for a loan at one of the foreign banks involved. ING's partners are Commerzbank (Germany), Crédit Commercial de France, Royal Bank of Scotland, Banco Santander and Bancario San Paolo di Torino (Italy). A broadly similar co-operation agreement exists between the Groupe Banques Populaires and regional banking organisations in Germany, Austria, Spain, Italy, Switzerland and Canada. In this case, the agreement concerns the money transfers of international clients.

A final option for serving more or less homogeneous groups is joint operations with third parties. For several banks, this could be an alternative to virtual banking. Co-operation can be with trade associations or financial institutions that specialise in certain emerging target groups, such as enterprises owned by women, environmental businesses or companies run by people from ethnic minorities. Apart from reducing costs, this sort of co-operation can increase the number of clients in the particular market segment. Co-operation arrangements can assume many forms, including distribution channel, first selection instrument or financing partner. One field where many banks already have co-operation agreements is in franchising - framework agreements are usually drawn up with franchise organisations at head office level and these are then filled in by local offices when talking to franchisees.

6. Conclusion

Problems in the relationship between banks and SMEs are partly a cyclical phenomenon, worsening noticeably during periods when economies are overheating (causing central banks to raise interest rates) or in recession (causing banks to reappraise risks and raise interest rate margins as a result). In fact, since the report of the first Round Table was published in May 1994, interest rates in Europe have generally fallen by around 30%. This should reduce the overall financial pressure on SMEs and help to create the conditions in which they can enjoy a better relationship with their banks. Even so, problems still remain.

Although SMEs want services which are competitively priced, and although there is now more information than ever allowing them to make comparisons between banks, for most clients cost is still not the overriding factor. What all of them generally desire is good, consistent service, delivered by a bank officer who is empowered to respond to their needs quickly and efficiently. They also want transparency: comprehensive information on the nature and costs of the services the bank provides and, where available, training on financial issues which improves their management skills and enables them better to understand the true value of the services available. If their expectations are met, they are willing to demonstrate a high degree of loyalty, in spite of conflicts which may arise, as evidenced by the fact that very few SMEs actually change bank.

One of the fundamental causes of difficulties in the relationship is the fact that SMEs remain largely under-capitalised throughout their lifecycle due to strong competitive pressures, taxation and a heavy administrative burden. As a result, the vast majority of SMEs are dependent on services by banks. Even so, only a minority of SMEs actively seek an alternative in the form of external equity, preferring to take on debt rather than suffer a dilution of control. Bank loans are therefore by far the most important financing instrument available to them and, as this report shows, banks have now recognised SMEs as their most important business partners and responded to the need to improve the relationship over the long term.

Banks accept that their relationship with SME clients can be further improved and the 'better practices' highlighted here show that recognition of this is only the beginning. In many problem areas, including those identified by SME representatives and accountants, all sophisticated banks are working hard to find solutions or at least to improve the situation. This is true of, among other things, their product range, tariffs, procedures and service. These are usually not just one-off actions, but are undertaken on a continuous basis. Banks are helped in these tasks by various external developments, such as liberalisation of banking legislation, introduction of advanced IT systems and new SME incentives from governments and private organisations. Moreover, the possibilities for further efficiency improvements are far from exhausted. Information technology is driving change, as are scale-enlargement due to mergers and competition, both actual and potential, from new financial service suppliers.

The question, however, is whether the ultimate goal - improving and intensifying the relationship with SMEs - can be reached by even more measures to stimulate efficiency improvements. The results are not always promising, as illustrated by the situation at the Bank of Ireland. As part of its efforts to support certain target groups, such as start-ups, the bank reduced tariffs or removed them altogether. Nevertheless, client satisfaction surveys showed that even these privileged users thought their banking costs were still too high, even though they were much cheaper than UK or European charges. Another example is support services offered free or at low prices to SMEs, an area where banks in many EU Member States stand head and shoulders above other organisations dealing with SMEs. However, these services seem to produce mistrust rather than appreciation, resulting from a perception that the support offered by the banks might not be robust. Moreover, a good relationship requires both parties to make an effort but SMEs too can be found lacking in this respect. For instance, it appears that there is insufficient recognition on their part of the need for transparency when dealing with banks and that the tendency towards shopping around is increasing. Furthermore, as customers they are not always very interested in products but want personal solutions to their problems.

Banks can only escape from this dilemma by striving to achieve real co-operation, a durable and lasting one-to-one relationship between themselves and their entrepreneur clients. This means close personal contacts, equality, mutual respect for each other's position, loyalty based on the principle "a promise made is a promise kept", an honest and open exchange of information, fairness and co-operation. Good co-operation is characterised by win/win relationships, optimal use of each other's "business potential", mutual support and SMEs not walking away because something is a little cheaper elsewhere or complaining immediately something goes wrong.

Most banks acknowledge that this is the path to follow and it is clear that many of them are already on good terms with a major part of their client base. The smaller, independent, local banks appear to have made the greatest progress here, a fact which is confirmed by, among other things, client satisfaction surveys: in the SME market segment they have the highest score. These results reflect the fact that such banks are able to target their client base more narrowly.

A key instrument in the policy for achieving a closer relationship and facilitating partnerships in almost every bank is the appointment of SME Account Managers (AMs) who have to be able to do more for entrepreneurs than merely offering banking products. Considerable demands are made on these AMs. They must be able to focus on their clients, put themselves in their position and fit in with the culture of SMEs - being flexible, searching for creative solutions to problems, having the courage to take decisions and demonstrating a consistent, committed approach. In addition, AMs must be willing to devote time to building close relationships, be available for clients day and night if necessary, be well-informed, carefully review the files before company visits and take an interest in the client's personal circumstances, since these can affect the health of the enterprise as well. Finally, AMs need to be part of good networks and to use their connections for the benefit of clients. All of these demands mean that banks put an increasing emphasis on selection and training.

The AM policy will only succeed if these front office workers receive sufficient support. They need enough freedom of action and authority to enable them to establish confidential relationships, which means a minimum of rules imposed from above. They also need to be given considerable leeway in how they carry out their tasks, for instance, being allowed to point out cheaper solutions to clients which, in financial terms, yield less (or in some cases hardly anything) to the bank in the short term. In contrast to what happened previously, AMs must be allowed to make their own decisions about granting or refusing a loan, or setting tariffs, based on their own knowledge of the potential of the enterprise and the qualities of the entrepreneur. In order to help AMs reach the right decisions and to relieve them of the need to spend a lot of time dealing with administrative matters, they need strong support from back office staff. It may also be desirable to equip them with pre-programmed laptop computers.

Obviously it is not considered necessary to use the AM approach for all SME clients. Moreover, not all clients can be served using the same AM system, which implies that segmentation should not be based primarily on offering products efficiently, but on whether there is a willingness to enter into a close and intensive relationship. This holds for both the bank and the entrepreneur. Once the choice has been made, the best form of account management needs to be identified, taking into account the needs of the clients and the usual effectiveness and efficiency considerations. All the distribution channels available - via offices, external intermediaries or mail and telecommunications - have to be considered when deciding on segmentation.

7. Epilogue

There is a new, increasingly warmer climate developing in the relationship between banks and SMEs. The actions described in this report show that all the banks involved in the Round Table are committed to overcoming the misunderstandings of the past and moving towards a genuine partnership. However, it is not possible to know if this is the case for all European banks dealing with SMEs or if the actions taken by banks are more an effort to treat symptoms than a long term strategic change.

This question is crucial in the light of the structural changes in SMEs and in their business environment, such as the increasing costs for technological innovation and quality improvement, growth in the number of start-ups, more dependency of SMEs on large enterprises, internationalisation, the need for niche strategies and the necessity of permanent change in organisational structures. All these developments result in a growing need for good external support.

The main issues for banks in their relationship with SME clients should therefore be :

- Creating a real partnership with clients based on mutual understanding of each other's needs and wishes, mutual respect and, above all, equality;
- Shifting the organisation's primary focus away from cost reduction towards client service;
- Using high technology within the bank not only for cost-savings and as a replacement for relationship management, but also as an instrument for perfecting the personal touch. In other words : combine it with more investment in people;
- Offering the benefits of the new information technology, such as extended databases, directly to clients;
- Using their networks of contacts for the benefit of SMEs;
- Searching for cooperation with other organisations who could contribute to SMEs' development, by providing added value for clients.

Creating the climate for such a policy cannot be entirely left to the banks, since they work under constant pressure to preserve their margins and do not have all the necessary resources and know-how to restructure themselves into fully SME-orientated organisations. Moreover, the world is becoming ever more complex, with organisations increasingly interdependent, even the biggest and most influential. Support from others is essential. This means that those who have a major interest in a flourishing SME sector - SME representative organisations, regional or national governments and European institutions - cannot stay on the side-lines but must offer their support to the banks. The Round Table's recommendations represent a good starting point for this process.

ANNEXE 1

CASE STUDIES

CASE STUDY 1
THE NATWEST BUSINESS ANGELS SERVICE

Research done by NatWest has shown that there is interest in a clear and well managed register of 'reliable' investors, both from the supply and the demand side. Existing intermediaries, such as accountants, venture capitalists and business advisors, have turned out not to be best placed to perform this function since, on the one hand, they wish to protect their clients and, on the other, they do not want to lose their advisory function. Moreover, it is often the case that opportunities put forward by these intermediaries are regarded as questionable by providers of informal capital. The main reason for this is the lack of knowledge about good investment prospects. A lot of so-called Business Angels, when they first start, seem to be ignorant of where to obtain adequate specific information. Existing British business networks, like LINC or VCR, have proved too small to handle this problem.

The NatWest research, in which 50 Business Angels and 47 intermediaries participated, showed that both enterprises and Business Angels thought that banks, like NatWest, are in an excellent position to implement a system which simplifies the private investment process. Since NatWest had the necessary means at its disposal and enjoyed the confidence of the participating parties, in January 1996 it extended its pilot Business Angels Service into a national scheme which is available at no cost to private investors and SMEs looking for capital. The first phase of the project consisted of setting up a database with potential investors and their preferences and with companies in need of capital and their requirements.

Enterprises who wish to attract capital have access to the Angels Service via their branch network or specific intermediaries, although there is no direct access to the NatWest Angels database. The intermediary supplies the enterprise with information about the application process and makes an inventory of all relevant information about the enterprise and its financial aspirations. Unlike the Angels Service, the intermediaries charge fees for their efforts. Among the intermediaries for the NatWest service are: Training and Enterprise Councils, TechInvest (information suppliers of investment possibilities), Business Links (one-stop-shops for general information and advice to SMEs), Local Investors Networking Companies and even the Stock Exchange.

The second phase consists of matching demand with supply. When a Business Angel wants additional information, this will be supplied by the intermediary. In the Angels Service, the intermediary carries out the function of a go-between who introduces the Business Angel and the enterprise seeking capital to each other. He does not supply advice about the investment itself. The NatWest Business Angels Service regularly reviews the information supplied by Business Angels who are still 'unmatched' with a potential investment. It often appears that only minimal change in the Angel's preferences can result in a successful match.

CASE STUDY 2
FPB'S RISK ASSESSMENT FORM

The British SME organisation Forum of Private Business has taken action to make the owner of a small business aware of the fact that his relationship with the bank is of great importance for the success of his enterprise. Following on from the results of its research, the Forum of Private Business distributed so-called Profit Builders to its members in January 1996. These are 'think through' educational tools to handle specific problems. They include documents like 'How good is the relationship with your bank?', in which bad practices of both the bank and the entrepreneur are included. There is also a 'Contract Check List Folder', which enables the owner-manager to assemble all his banking documents as a first step towards a contract.

Another FPB Document is the 'Risk Assessment Form', which gives the SME entrepreneur a better understanding of the risks that he or she and the business are exposed to. This document offers the opportunity to reduce these risks, after which the entrepreneur and bank can compare to what extent their assessments of the risks differ. With the Risk Assessment Form, the Forum of Private Business is trying to reduce the problem of information asymmetry. By giving the entrepreneur insight into the procedure and risks of the bank, it is made clear to him why he must provide information under all economic conditions in order to enjoy a good or better relationship with the bank. It is explained that the provision of this information implies a reduction of the risk to the bank, resulting in lower risk premiums and thus in lower interest charges.

The Risk Assessment Form contains a questionnaire, consisting of 12 different types of questions **(see Annexe 4)**. On the basis of the answers given, a score is awarded for each section from which a total score can be calculated. This total score determines the amount of risk - the higher the score, the higher the risk - and with that the risk-premium on top of the basic interest rate that has to be paid.

In the explanation of each section, it is made clear that the bank may have a different point of view to the entrepreneur and may use different risk-standards. It is also explained that this need not be conclusive, but that discussion is necessary in order to agree on a logical risk-standard which will be used in future. Emphasis is put on how to approach a discussion with the bank in case of disagreement, with a view to reaching an agreement on the assessment of the risk by the bank and the entrepreneur. The ideal result is agreement on a method to estimate risks which the entrepreneur knows will be used henceforth. When the entrepreneur knows how the bank judges the risks associated with his enterprise and thus fixes the risk-premium, he can improve his risk score and help to reduce the interest rate he pays in the future.

CASE STUDY 3
ITALRATING BY MEDIOCREDITO CENTRALE

Lack of funding and insufficient capital for the financing of investments and development growth are probably the main problems that SMEs have to face. In order to encourage the flow of capital to dynamic enterprises and to contribute to the private bond segment, Italy's first credit rating institute has been founded by Mediocredito Centrale (35%), two important business research institutes, namely Databank (27%) and Nomisma (27%), Unioncamere, the Italian Chambers of Commerce (10%) and Unione Nazionale Dottori Commercialisti (1%).

Italrating's objective is assessment of the credit-worthiness of companies, institutions or other obligors and of the solvency of their debt obligations. Services offered by Italrating are rating, monitoring and other rating services. The rating assessment applies to short-term securities (commercial paper or other financial market instruments) and medium-term obligations. The ratings are subject to continuous monitoring throughout the lifetime of the obligation and a rating review is conducted at least once a year.

Italrating can undertake preliminary and confidential rating assessment of current or potential clients of banks and financial institutions, and issuers/issues on behalf of private and institutional investors. In such cases, rating can also be assigned as a range of rating categories. The assessment process is consistent with the one applied in assigning ratings.

Target clients of Italrating's services are issuers interested in diversifying their sources of financing and reducing their debt-servicing costs, through direct access to institutional and private investors, and investors planning to optimise their risk-evaluation procedures by using the rating. Italrating is based in Milan. Underwritten and deposited stock is worth 1 million ECU. The scale of credit rating is the same as that used by most international credit rating institutes, ranging from AAA to D.

CASE STUDY 4
THE FRENCH MUTUAL GUARANTEE SOCIETIES

Mutual guarantee funds give enterprises better access to bank loans. In France this system is organised by so-called Mutual Guarantee Societies. The total sum of guarantees granted in 1994 was about 10 million ECU, benefiting some 20,000 enterprises. Mutual Guarantee Societies are founded by SMEs on a voluntary basis, often working in one specific sector, in order to help satisfy the credit needs of fellow enterprises. Their investment portfolio must be very liquid and speculation is strictly forbidden. The purpose of the Mutual Guarantee Societies is to safeguard the professional and personal activities of their shareholders, rather than to generate profits. They make contact with SMEs who require loans by means of their local reputation, in co-operation with the regional bank. The bank, however, does not play an exclusive role as intermediary. A Mutual Guarantee Society consults the banks when checking guarantee requests but plays the leading part in the decision process. The assessment criteria used consist of judging the entrepreneur as an individual, the business proposal, the sector and, of course, the usual financial criteria.

A Mutual Guarantee Society consists of a General Meeting, where the decisions are made, an executive Committee and an internal supervising body. For the supervision of the activities of the Mutual Guarantee Societies, there is a particular organisation. This is then responsible for the technical and financial supervision of the Mutual Guarantee Society, the (risk) management, the economic and financial forecasts and the statutory and legal regulations. Furthermore, the department has to propose or to implement measures in order to secure the liquidity and solvency of the Society. The supervising department also takes decisions on the share capital and the associated regulations. The Mutual Guarantee Society has to give information to the supervising bureau periodically about its financial position and the guarantees it has granted. Besides this, the department can support the Mutual Guarantee Society with information, legal and fiscal advice, training and general services.

The guarantee granted to the applicant can be restricted to a certain sum or be extended to the full loan offered by the bank. The guarantees vary from FF100,000 to 2 million per enterprise, although there is no maximum or minimum to this amount. For every bank loan granted there is a guarantee of 50% minimum and 100% maximum, where the loan is considered to be a regular bank credit at a normal interest rate. For the bank there are no additional costs, since the management of the guarantees is done by the Mutual Guarantee Society itself.

For the entrepreneur the biggest advantage of the mutual guarantee system is that it avoids in many cases having to take mortgages. This with a guarantee premium under 0.5% per year. The advantage for the bank derives from the evaluation of the risk by responsible and voluntary enterprises. Because the enterprises in the Mutual Guarantee Societies are often grouped locally or regionally, they have good insight into the specific market conditions, which makes an accurate assessment of the relevant risks possible. In addition, the quality and solvency of the guarantees are an important advantage for the bank.

CASE STUDY 5
MAMA CASH AND SUPPORT TO WOMEN ENTREPRENEURS

Despite the fact that The Netherlands provides a relatively good climate for SME financing by banks due to the effective national loan guarantee scheme, many SMEs are still faced with considerable problems in obtaining the capital they need. These are start-ups, women in business and immigrants in business. The most difficult case is that of SMEs combining all three characteristics at once: being a woman, originating from an ethnic minority and wanting to start her own (small) business.

Mama Cash does not provide loans, but (additional) guarantees to persuade bankers to offer loans to female start-ups without enough collateral. The current capital of Mama

Cash is about 1 million ECU and the annual budget for all activities about 400,000 ECU. The biggest part of the income now comes from fund-raising.

The loan guarantees of Mama Cash can be up to 25,000 ECU for a maximum of 3 years, subject to a number of criteria being satisfied, including submission of a full business plan and the prospect that the entrepreneur will be able to support herself from the business after 1 year. Guarantees are only provided if the financing proposal has been refused by local banks (a few of whom actually advise applicants to apply to Mama Cash). Applicants for guarantees are also expected to raise at least some money privately from family and friends. The guarantee itself is limited to 50% of the loan requested. The other half of the risk must be covered by the bank. In practice the bank can appeal to the national loan guarantee scheme for its part of the risk coverage. For its service Mama Cash asks a 1% commission over the guarantee granted.

Hundreds of start-up female entrepreneurs call Mama Cash for information every year, and about 70 per year apply for a guarantee. Only 10% ultimately get a guarantee, so the number of guarantees is still very low. Reasons for refusal are: the plan is too premature, the budget can be lowered so that a guarantee is no longer needed, Mama Cash's advice gives enough confidence to the bank to offer a loan without an extra guarantee, and women succeed in finding other financiers.

Most of the start-ups supported are in sectors traditionally associated with women, but also include software, agriculture and business services. About 25% of the women involved are in receipt of government social security support, they have an intermediate level of education and vary considerably in their degree of previous business experience. Since Mama Cash decided to support more immigrant women and intensified its PR activities towards this target group, their share has been growing: in 1995 about half of the assigned guarantees fell into this category.

In addition to guarantees, Mama Cash is also an important source of advice for women wishing to start in business, helping them to improve their business plans and directing them towards other specialised advice where appropriate. Mama Cash is a foundation and does not intend to function as a bank, preferring instead to focus on areas which are not well served and where it can make a real contribution to enhancing the prospects of women entrepreneurs. Although it does not operate for profit and margins are low, its guarantee fund produces a surplus and requires no government support.

CASE STUDY 6
THE CUSTOMER CARE SERVICE OF THE SPANISH SAVING BANKS

In 1995, the Spanish Savings Banks Confederation (CECA) carried out research to assess the procedures followed by the associated banks to handle complaints from their clients. 43 out of the 50 savings Banks have their own structure taking care of their clients' interests. This structure is usually called "Servicio de atención al cliente" (Customer Care Service).

The Customer Care Services have three main objectives. First to attend to and solve complaints, objections, protests or claims but also mere consultations of clients. Secondly to detect deficiencies in the quality of the banking services. Thirdly, to win the loyalty of customers.

The Service is generally located in the Savings Bank itself and forms part of the commercial department, except in the case of the 10 Catalonian Savings Banks which have a so-called 'customer protector' at regional level for all 10 Banks.

Clients are aware of this option through several communication means: leaflets, bill boards. Letterboxes, etc. Clients can reach the Customer Care Service through the branch offices, by mail and telephone or simply by going personally. On average the Customer Care Services together receive 3.8 complaints per day (out of a total of 43 million clients). Two thirds of the complaints are solved within 15 days. The maximum detected answering time taken by a bank was 3 months. Statistics are made on an annual basis with a monthly follow-up in most cases.

If the customer is not satisfied by the financial institution's response, he may appeal to the 'Complaints Service' of the Bank of Spain. This service publishes an annual report which deals with accepted best practices and aims to contribute to making the bank/customer relationship healthier. Commercial banks receive the greatest proportion of complaints (60%), followed by Savings Banks (28%).

CASE STUDY 7
INFORMATION SERVICES OF THE GERMAN SAVINGS BANKS

DSGV, the German Savings Bank and Giro Association, has created several Information Services, especially for SMEs. From these Services the entrepreneur can get topical information about all sorts of subjects very quickly.

Branchendienst (Sector Service), offers statistical data for local industry. From this Service the clients of the Savings Banks can obtain, free of charge, information about the current market situation and the developments within the individual sectors of trade and industry. Every year the Sector Service also publishes an outlook for the various sectors for the coming twelve months.

Another activity of the Savings Banks is 'Database Investigations'. This Service collects and distributes information on opportunities for joint ventures, co-operation, import and export transactions and for ecological products and production.

Within the Savings Banks there is also a Euro Info Centre, affiliated with the official EU network of Euro Info Centres in Europe. This Centre offers its services especially to SME clients via the local savings banks. Services available are: support for internationalisation of SMEs; a European Newsletter; information and advice on promotion programmes, European legislation and the investment climate in the EU and in other countries; and a PC advisory programme called 'Euro-expert'.

Finally the Savings Banks have several periodically updated publications. One of the most important is "Geschäftswelt" (Business World), with information about government support programmes, databases and data processing, latest developments in management administration, details on new markets and products, and developments in Europe. The second publication is "Außenwirtschaft" (Foreign Trade) with international economic data, a country information service, international market assessment, international trade promotion services, and tips and hints in connection with legislation.

CASE STUDY 8
CLIENT REPRESENTATION IN THE ÖVB

The Popular Banks in Austria were set up by individuals and small and medium-sized entrepreneurs with the aim of receiving financial assistance based on their own means, a situation which is still the same nowadays. A large number of clients are also shareholders - around 30% and growing - and an entrepreneur or private individual can own up to 11,000 ECU of the capital of a Popular Bank. Profits are distributed and the long term return is around 8%.

More important than the return on the shares is the right to vote. Unlike most listed companies, this right is not based on the number of shares held but rather on a nominal basis. Every shareholder has the right to chose, or to be chosen as, a delegate, each delegate representing 100 shareholders. The delegates take it in turns to elect the 6 to 8 co-operative councillors who take decisions concerning the bank managers' salaries as well as on the accession and exclusion of existing members. Four times a year the co-operative councillors have joint meetings with the board of directors in order to discuss the current situation and development of the bank, activities for SMEs, the market situation in the region and the problems in the various business sectors.

Apart from electing the co-operative councillors, delegates are also involved in managing the bank. Once a year informal meetings are organised in sub-regions (5-7 branch offices). The purpose of the meeting is to intensify communication with clients, to get a better understanding of the problems of SMEs, to increase confidence in the bank, to enhance understanding of the bank's policy and actions and to stimulate a partnership between bank and clients. The delegates also have the opportunity to talk individually with one or more members of the board of directors. As a result of the meetings there is a high degree of affiliation on the part of delegates and clients to the Popular Banks in Austria. On the other hand, the banks' management gets a good understanding of developments in the various business sectors, of the regional markets and of the problems facing SMEs. This helps banks to offer customised banking products and to stand by their SME clients when they have problems.

CASE STUDY 9
SWEDBANK'S STAFF TRAINING PROGRAMME FOR SME FINANCING

Like many other banks in Europe, Swedbank faced a range of problems and challenges in dealing with the SME market, a priority sector for the bank which was attracting more and more attention, as witnessed by the introduction of new products, services and techniques. It knew that the competence and experience of its staff would be crucial in enabling it to respond to and develop this sector, whilst also managing the credit risk inherent in SME banking.

As a comprehensive response to this situation, in 1996 Swedbank launched a new training programme for its SME staff with two clear objectives. Firstly, to boost the bank's competence in servicing the particular needs of its SME customers. Secondly, to create a sales organisation which was both proactive in its approach and sensitive to customer needs.

One year was spent planning the programme, borrowing principles from the academic world. Diplomas are not awarded until the student has passed all the examinations and demonstrated that they have reached the required standard. In addition, it is made clear that the programme requires a full time commitment. There is even an agreement with each participant's family to make them aware that, during the 7 to 9 months of training, the participant will need to work in the evenings, at weekends and even during holidays.

Each participant is carefully selected, together with a coach (a senior colleague). The training programme is divided into 7 different subjects, including accounting, law, policies and entrepreneurial skills. The students work together in fixed groups, individually and in class.

In order to understand the circumstances under which many entrepreneurs work, everyone has to go through all the steps involved in setting up a company. This covers drawing up a business plan, preparing budgets, contacting the necessary authorities, etc. Last but not least, the students must go through the banking process, including setting up accounts and requesting credit.

Students graduate after having passed all the tests during the programme. Having done this, they then make their own evaluation of the experience and their comments (to which the greatest importance is attached) are used to improve the programme. First reactions have shown that the students find the programme both more stimulating and more demanding than they expected. Successful students receive a diploma but, more importantly, they are much better equipped to respond to SMEs' needs and also open up better career prospects within the bank. Moreover, they have a network of former classmates and teachers on whose experience they can draw in the future, helping them to solve problems more quickly and effectively.

From the start, the training programme has been oriented towards the increasing internationalisation of SMEs. This emphasis will be further strengthened in the second phase during 1997.

CASE STUDY 10
ACCOUNT MANAGER TRAINING AT NATWEST BANK

The key challenge and opportunity in improving the relationship between banks and SMEs is to increase mutual empathy and understanding. One side of the responsibility lies with the individual SME and SME organisations in encouraging exchange of information and regular dialogue. The other challenge is to the banks.

Over the last five years, NatWest has fundamentally changed its approach to the training of its Account Managers, essentially by moving the emphasis from classroom based training to experience of working with SMEs. This is not to say that traditional course-based teaching of cash flow, balance sheet and financing techniques has been abandoned. Rather this has been supplemented by an uplift in emphasis on cash flow viability, rather than collateral values and the development of new techniques.

In 1992, within the framework, NatWest started a joint programme with Durham University Business School (DUBS) whereby account managers spend five days at Business School, including one day shadowing an SME owner-manager. This course is taught by a mix of SME owner managers and academics. 1,200 staff have attended this programme.

In 1995, the second stage of this move was the development of the Linkage programme, also in conjunction with DUBS but working with the Business Links (support agency). Account managers attend the five day DUBS course above, but additionally spend four weeks working (for no charge) in an SME in non-financial areas, e.g. production, distribution. This produced considerable improvement in mutual understanding between banker and SME owner-manager. This programme has been extended in 1996 with other support agencies added.

In 1996, NatWest joined the new Business Bridge project (PLATO scheme in Belgium) in which account managers, along with staff from other large companies, act as mentors to groups of SMEs.

CASE STUDY 11
GIROBANK BIKUBEN'S EXPORT CONSULTANCY SERVICE

In 1987, Bikuben Bank established an Export Consultancy Service aimed at small Danish SMEs wishing to export to European markets, primarily the German market. The services it offers are provided by consultants with at least 10 years' practical experience as export managers and SMEs can also consult a German advisor, who operates from Frankfurt, about specific market conditions related to their products or services. The export service is financially supported by Bikuben Bank's International Division.

In addition to practical assistance with the implementation of the entrepreneur's export plans, assistance is also provided in the preparatory phase. This includes:

An export sales review, which looks at the company's sales organisation and (potential) export markets, the company's individual customer potential, sales strategy, budget and sales targets, the terms and conditions of sale and delivery. The consultant examines whether these areas need to be strengthened before exporting and develops strategies with the aim of increasing both efficiency and the chances of a successful export policy. The company is charged directly for this review at a daily rate.

An independent export employee: after the review has been carried out, the export consultant can take the role of an in-house employee and examine whether export opportunities for the product or service can be created, improved or increased. He undertakes a mini market-survey, prepares and circulates sales letters, handles replies and follow-up on enquiries to which the company had not received replies, assesses, selects and visits customers, draws up standard contracts, prepares sales budgets and plans for action. Once this task is complete, the export consultants involvement in the company ceases. Should problems arise with the export activity, the entrepreneur can still seek advice from the consultant by telephone for a further year, a service for which he will also be charged at a daily rate.

Results from the Export Consultancy Service are mixed, mainly due to the fact that the service is used by widely differing types of companies. The advantage for the bank is that it gets an inside view of the financial needs that emerge when a company is exporting. With this knowledge, Bikuben is currently in a better position to respond overall to an exporting company's specific requests and needs.

CASE STUDY 12
DSGV'S NETWORK TECHNOLOGY EXPERTISE

In Germany, between 15,000 and 18,000 small and medium-sized companies are involved in research and development. Their need to market either inventions, new technologies or technical advances has resulted in stronger demand for loans in the field of innovation financing. Such projects need to be examined very closely by the bank in order to offer tailor-made financing solutions, but the loan specialist is normally not in a position to judge the complex technological issues involved and evaluate their risks and/or chances of success. He needs external support.

For this reason, the DSGV (German Savings Bank and Giro Association) started a project called Netzwerk Technologiegutachten NTG (Network Technology Expertise) together with the Fraunhofer Gesellschaft, a scientific organisation of international repute, in order to offer the local savings banks a network of highly qualified experts they can turn to for an independent opinion.

The main elements of the pilot project are:

- providing a network of highly qualified experts to give both technical and market opinions
- creating a link between the savings banks and the experts responsible for finding and appointing the appropriate expert and controlling the quality of this work
- providing a step-by-step system of expert opinion at moderate fixed prices
- ensuring rapid progression through the whole process

This allows the German Savings Banks to make well-founded, rapid judgements as to whether and how innovative business proposals will be financed.

The pilot project was opened to all German Savings Banks from September 1996.

CASE STUDY 13
COMMUNITY INVOLVEMENT OF THE BANK OF IRELAND

Bank of Ireland has a comprehensive range of supports for schools, third level colleges, business schools, the Arts and sporting organisations, Its purpose is to assist in development of commercial skills of potential entrepreneurs and to foster cultural development for the community at large.

A schools co-ordinator is nominated in each District Office, services offered include presentations, mock interviews and help in setting up mini companies which facilitates the application of the theory of business organisation.

Bank of Ireland sponsors an Enterprise Award Schemes organised by a number of Religious Orders who are active in school management throughout Ireland. This is designed to raise the students' awareness of business and enterprise by applying theory to real situations. Students choose a local amenity service or product as a basis for a job creation scheme. The first prize is an educational experience in Europe for the team from the winning school.

The Bank sponsors the "Business Development Programme" which is run by the Irish Management Institute, the leading management training organisation in Ireland. This programme targets fast track developing companies making a significant contribution to economic development in their own localities. A Chair of Banking at a University has also been sponsored and the Bank is actively involved in a new third level Rural and Business Development Institute which will focus on the provision of innovative education, training and service for students who wish to establish SMEs in non-urban areas which will assist in sustaining rural development.

Bank of Ireland has also sponsored "Up & Running", a competition for SMEs which is televised on the National network. Many companies have been helped to succeed by exposure in this competition. The bank also sponsors a National SME Conference in conjunction with a national newspaper.

On the cultural front Bank of Ireland sponsors the All Ireland Gaelic Football Championship. This is the main indigenous sport in Ireland and is a very important part of the country's cultural heritage. On the Arts front, the bank sponsors the Proms, which is also televised nationally, bringing classical music at an affordable price to many people. Numerous other regional sponsorships are conducted on the business, sporting and cultural fronts, with particular focus on agricultural sponsorship given Ireland's substantial dependence on this sector.

CASE STUDY 14
NATWEST'S BUSINESS COMPETITIONS

All of the major British Banks are involved with SME competitions at national or local level or both. These competitions are run with a variety of objectives from the banks' perspectives: marketing tactics to attract and retain quality business; investment in improving awareness of the benefits of financial literacy and management planning (lower risk); strengthening links with co-operating organisations; positive marketing and PR.

NatWest activities in the field of SME competitions have included:

Students/schools

- Business plan creation for new enterprise by local schools in London in co-operation with Surrey TEC. Target group: 14-16 and 16-18 age group. Assisted by the local NatWest schools co-ordinator. Prizes of PC's, software and cash.

Start-ups

- Livewire awards in conjunction with Shell UK and other banks/corporate sponsors. Target group: young entrepreneurs only. Cash prizes.
- Princes Youth Business Trust competition (again with other banks). Target group: young entrepreneurs. Cash prizes.
- Daily Mirror (national newspaper) competition. Target group: all start-ups. Prizes of vehicle, PC and cash.

Existing businesses

- British Knitting and Clothing Export Awards in conjunction with Trade Association. Prize: cash sponsorship.
- Welsh Fashion Business Awards in conjunction with Welsh Development Agency. Prize: cash sponsorship.
- Agricultural Enterprise Awards in conjunction with Farmers Union. Prize: cash sponsorship.
- Sunday Times Business Innovation Awards. Target group: innovative businesses. Prize: cash sponsorship and trade exhibition space.
- Devon and Cornwall Business Challenge in conjunction with local TEC's, accountants and solicitors. Target group: local businesses creating jobs. Cash prizes.

CASE STUDY 15
ING BANK'S SUPPORT TO WOULD-BE ENTREPRENEURS IN FOOD RETAILING

In 1984 the former NMB Bank (now ING Bank) decided to support an initiative to improve enterpreneurship in the food retailing business. Five important food retailing organisations, so-called voluntary chains, took an important decision with the assistance of the NMB Bank to establish a training institute, called Profood, for the improvement of enterpreneurship in food retailing. The six institutions had increasingly come to the conclusion that sound enterpreneurship was one of the key factors for future success in food retailing. Changes in consumer preferences and shopping habits required larger supermarkets and consequently this meant a heavier burden for the supermarket owner. At the beginning of this process the voluntary chains were not in a position and not equipped to follow this trend. This started a dramatic decrease in the market share of voluntary chains in relation to the chains with company-owned stores and strong central management. The voluntary chains desperately needed better locations, larger stores, better commercial concepts, better decision-making processes and, above all, better management skills at local level.

The six partners (Spar, Markant, Unigro, Schuitema, Sperwer and NMB Bank) put up money and the Ministry for Economic Affairs supported the initiative with a subsidy for a number of years. This made it possible to establish a training institute and to develop the necessary courses. The Profood Foundation today is an institution that runs a four year training program for students who are planning to start their own supermarket. Usually that means a take-over of an existing one. In the four years the student has theoretical training (especially in the first year), plus training on-the-job at selected enterprises to further enhance his skills. After graduation the student usually spends some years as a trainee in a supermarket or commercial organisation before opening his own supermarket.

After 12 years the bank is still active in Profood. The Supervisory Board consists of representatives of the retailing organisations (of which there are now 11), an equal number of entrepreneurs, ING Bank and an independent Chairman. Apart from being a supervisor, the bank is also involved in the training programmes. The subjects of Business Planning, Strategic Management and Financial Planning are developed and taught by experts from the bank. Every year students spend one day at ING Bank to make themselves familiar with financing issues in a modern supermarket.

The income sources for Profood are the contributions of the participating retailing organisations, sponsorships from the food processing industry, training fees, etc. The programme is constantly updated, a process which requires a lot of effort and money. The annual budget amounts to 600,000 ECU. At present the institute has 112 students spread over 4 classes. In the 11 years of its existence, Profood has turned out approximately 180 graduates, of whom 60 at present have their own firms.

CASE STUDY 16
NATWEST'S SECONDEE PROGRAMMES

All major British banks are active in placing their staff into Business Support Agencies, SME organisations and even Government departments. The primary purpose is to widen their staff's understanding of SMEs and their environment, although there are secondary objectives in terms of positive PR and, at a low key level, improved business flow from the host agency. Placements into organisations usually last from six months to two years. At the end of the period they return to their home base, either to their previous position or to a new one.

NatWest's activities in this field have now been running for more than 10 years. At any one time around 25-30 staff are on secondment. Since the start of the programme about 200 staff have been through placements. The majority of the secondees have returned as SME Account Managers where they can apply their greater understanding to the benefit of the SME and the business. The programme is centrally administered by Small Business Services, the NatWest SME policy directorate, and staff salaries during secondment are met from a central budget. Staff are nominated by the local regions or by the staff themselves.

Host agencies are mostly recommended by the local regions or by direct approaches to the central unit. Current secondments include the following types of agencies:

- Business Links
- Training and Enterprise Councils
- Local Enterprise Agencies
- Innovation Centres
- Two SME organisations

• Norfolk Small Business Initiative

In the first three organisations, secondees typically act as business advisors acting on behalf of SMEs from all banks. They must act objectively to retain credibility with the client. Conflict of interest has not proved to be a problem.

CASE STUDY 17
EU SUPPORT UNIT WITHIN COMMERCIAL BANK OF GREECE

Since both banks and clients operate within the framework of the internal market, each needs to understand and absorb the associated regulatory and structural policies, actions and measures. Thus analysing the policy framework and identifying changes to it and their implications are matters of considerable importance.

In order to provide information, consultancy and support to departments within the bank, as well as to clients, on matters concerning the EU, the Commercial Bank of Greece has set up a European Affairs Unit of five policy analysts within its Economic Research Division. Good clients can currently use its services free of charge by asking their Account Manager.

The primary task of the Unit is to analyse the policies and measures designed to complete the internal market, in order to identify their possible implications and any changes which may result. Attention is focused on issues relating to the administrative provisions for activities undertaken by financial institutions, harmonisation of banking supervision, the system for dealing with crises and the smooth functioning of the capital markets.

The Unit's second task is to provide SME Account Managers with useful background information about the European policy framework in which their clients have to operate, as well as the sources of finance available to SMEs. The Unit currently concentrates on the following areas:

• consulting Account Managers about the Community's Support Framework 1994-1999, as well as about the Community's initiatives and how their clients could benefit from them
• reporting on the policies for a number of sectors and/or products according to the client's business and the available sources of funding
• preparing the AMALTHIA (Euroselect) database which will include all the available investment incentives from national and European sources
• consulting the bank's management about the possible financial opportunities stemming from the activities of the European Investment Bank and European Investment Fund

The Unit's third task is to analyse the framework of the EU's external relations with third countries in order to identify the possible opportunities arising for the bank and its clients. It has recently focused its attention on the countries of Central and Eastern Europe, as well on the Mediterranean countries.

CASE STUDY 18
NATWEST'S INNOVATION AND GROWTH UNIT

An increasing number of companies who approach NatWest for financing need special treatment and attention. These are usually technology-based firms and young enterprises with high growth potential whose development is being obstructed by fundamental misunderstanding of their problems on the part of those organisations from whom they request financial support. The business plans presented frequently contain enormous and barely believable growth predictions, which seldom indicate a steady growth pattern for cash-flow. Moreover, such enterprises usually operate in a non-existent industry or a market where track-records are lacking. Finally, the investments requested are usually high, but with little or no certainty to offset the risk.

In order to improve its approach to this type of business, NatWest has developed a special support unit run by Technology Business Managers (TBM) who have an appreciation of and experience with unusual cash-flow patterns and the resulting financial needs. This enables the TBM to provide the entrepreneurs with practical support and, if necessary, refer them to experts. For the valuation of technology-based and high potential firms, NatWest has developed a special method: the New Technology Appraisal Service (NTAS). Traditional financial benchmarks and track-records are given less weight than usual and more attention is focused on the market environment in which the enterprise operates. The appraisal process is carried out by independent marketing consultants as opposed to bankers, so the greatest emphasis is put on the market evaluation. The results of an NTAS investigation are put into a report which is discussed with the client. Working together with the entrepreneur, the TBM draws up plans for future development, thus establishing the basis of a relationship between client and bank.

In contrast to other British banks, which offer special services from their head office, NatWest delivers these special services from their local offices. An international network has been created consisting of 150 TBMs who are mainly concentrated in areas with a large number of technology-based and innovative firms. The decision as to where best to locate the managers is taken at regional level - this ensures that every part of the bank is aware of the concept and can give an optimal response to the needs of the client. By putting TBMs in the offices instead of a central department, an innovation culture is being created, which provides NatWest with the image of a technology- and innovation-orientated bank. The TBMs are supported centrally with essential information and advice, one example being a special hot-line to provide a rapid response to questions concerning new technologies and their markets. At this level there is also co-operation with national and European research institutions. Networking is essential for the success of the project: building a partnership with the local technology and innovation community.

CASE STUDY 19
BANK OF IRELAND'S STRATEGIES FOR RISKY NEW BUSINESSES

In response to government concerns about the lack of finance for start-ups, the Bank of Ireland has developed various products, services, strategies and structures. The Enterprise Support Unit (ESU) was set up in order to finance and assist these business in their early stages.

To assist micro-business start-ups, the Bank participates in a joint programme with First Step, an external non-profit organisation. Since the Bank of Ireland launched its new Enterprise Banking policies in 1995, start-ups can also count on the support of specialist Enterprise Advisers, appointed in all 60 District Offices.

Under the terms of the new Enterprise Banking policy, start-ups received substantial fee concessions. For instance, in the first year they do not have to pay any current account fees, commission on domestic drafts, fee for night safe facilities or charge for company credit cards. Fast-growing young companies can also benefit from subsidised Invoice Discounting and subsidised long term loan finance for business property. Training is also provided to entrepreneurs in key business skills.

The ESU operates as a high risk lender. Businesses who would not be financed under conventional banking criteria find a ready ear for their proposals. From its inception in 1989 until the end of 1995, ESU supported more than 300 start-up companies resulting in the creation of 3,700 new jobs. The lending range is between 30,000 ECU and 250,000 ECU with an average loan of 75,000 ECU. Despite the low level of access and flexible conditions, ESU lends to only one out of four proposals. The remaining proposals are not viewed as commercial. The cumulative loss of ESU is 10%, which suggests that losses would be even higher if any of the remaining uncommercial proposals were funded. Therefore for start-ups in the ESU, Bank of Ireland takes higher risks. Personal guarantees for obtaining a loan are not required and risks are not loaded with higher interest rates.

On the contrary, credits to start-ups are provided on the basis of an AA-rating. The guidance of start-ups by ESU is very intensive and account managers develop a close relationship with the businesses.

The joint programme of Bank of Ireland with First Step, started in 1994, provides finance and business expertise to those with good micro-business ideas to get started. Its main aim is to support people with entrepreneurial talent who would not normally have the opportunity to set up an enterprise. The initiative addresses the problem of job creation on a practical level and has targeted the private business sector to assist in getting projects off the ground. Loans are on a three year term and interest free. Every accepted new entrepreneur is provided with a voluntary business mentor. First Step focuses on businesses which are at a pre-start-up stage, do not have the ability to raise sufficient funding elsewhere and have potential for long term viability. The business, however, must have a specific job creation element with particular emphasis on new projects by unemployed people. Finance is provided up to a maximum of 32,000 ECU.

CASE STUDY 20
PARTICIPATION OF VOLKSBANK SALZBURG IN TECH-INVEST

In 1987 four banks in the Salzburg region, among them Volksbank, founded Tech-Invest G.m.b.H., a private limited investment company. Their main objective was to develop business and innovation centres in the region in order to support and stimulate technology-based activities.

The first step was the development of Techno-Z, currently the largest science park in Austria and affiliated to the Polytechnic University of Salzburg. When first established the park only comprised an incubator centre of 2,100 m^2 which could be rented to start-ups and young enterprises in high-tech services and in electronics. Prior to its opening the management of Techno-Z, in co-operation with the four banks, carried out a rigorous selection procedure - 19 companies from 84 applicants were initially selected. The final choice was left to representatives of the regional government and of the Chamber of Commerce.

Since then 6 other buildings have been built, giving a total floorspace of 12,500 m^2. 78 enterprises, employing about 575 people, are currently established in the park. Techno-Z offers the companies favourable rents, the use of a central secretariat and shared conference and training rooms. At present, Techno-Z is now entering a phase of great expansion, which will see it nearly double in size. Three new buildings will serve as a MultiMedia Business Park for offices, studios and production sites for multimedia businesses. The central facilities and services will be geared towards this new target group. Also, the Polytechnic University now offers three separate 4-year study programmes in: Telecommunications Technologies and Systems, MultiMediaArt, Communications and Business Management and Media Business.

Tech-Invest has since created new technology centres in other parts of the Salzburg region: one centre for ecologically-orientated service companies and technology firms, one for the tourism and leisure industry and one for trade. These centres are all at an early stage and are foreseen as being substantially smaller than Techno-Z. All four centres are connected with each other. The Chamber of Commerce is responsible for organisation and management, the banks offer free advice and cheap loans, whilst the regional authorities offer loan guarantees and interest subsidies. In addition, there is substantial interaction between companies and academic institutes in the region.

The park is self-financing. Since 1988, 113 enterprises have been housed in one of the buildings and 26 companies have moved out. The reason for most of the departures was expansion and the entrepreneur's wish to move into his own premises. All of them are still in the Salzburg region. Only 5 of these companies have gone bankrupt and a further 4 closed due to the entrepreneur finding a more attractive position as an employee in another firm. The largest firm in Techno-Z currently employs 73 people.

The main reason for the success of the project has been the collaboration between local government, Chamber of Commerce and the four banks, the advisory service in Techno-Z, from which all enterprises in Salzburg benefit, and the close ties between the companies and the academic world.

CASE STUDY 21
"DE ZAAK" (THE BUSINESS), THE TOTAL BUSINESS SUPPORT CONCEPT OF DUTCH POSTBANK'S DIRECT BANKING

The Dutch Postbank firmly believes in the growing market for Direct Banking as a distribution channel for the SME sector and invests heavily in the concept.

To strengthen the ties with their clients, the Postbank entered into an alliance with an independent publisher to produce their latest magazine, called De Zaak, which is aimed at the private and business affairs of small entrepreneurs. Since 1992, this magazine has been distributed 6 times a year to 125,000 Postbank clients with fewer than 20 employees. Non-clients have to subscribe or buy it at a bookseller.

Since the introduction of the magazine, the concept of giving advice and information 'at a distance' has been extended. Two years ago the publisher, with the help of Postbank, started a series of booklets, published 4 times a year, on specific business topics such as 'The entrepreneur and his car', 'The entrepreneur and his computer' and 'The entrepreneur and his (private) taxes'.

In 1997, a new page in the concept was turned with the development of 3 new services in collaboration with several companies. Contracts have so far been signed with Exact Software, Microsoft, Compaq, Minolta, Dutch Telecom, Graydon (Business Investigation Services), Marktselect (Business Data Bases), Vedior ASB (Temp Agency), World Online and Moret, Ernst & Young. The three new services are:

- **De Zaak Manager**: a specially developed software programme for financial and employee administration, access to Internet, E-mail and a business directory.

- **De Zaak InfoNet**: access to different sources of information via Internet, divided into different service sites such as:
  - **De Zaak ABC**: business encyclopedia
  - **De Zaak Product Info**: information on all products and services offered in the Netherlands
  - **De Zaak NetNews**: up-to-the-minute financial news
  - **De Zaak Business Bank**: Current information on businesses to let or to buy
  - **De Zaak Business Angels**: current information on informal capital available and required
  - **De Zaak Temp**: a quick search facility for temporary employees
  - **De Zaak Property**: current information on premises available and required

- **De Zaak Advice**: this service will start from the 1 January 1997. Business clients from the Postbank can then get information and advice from (retired) experienced entrepreneurs by telephone. The team of entrepreneurs, who will act rather like mentors, has already been selected. The Postbank client can also get advice by phone from experts from accountancy company Moret, Ernst & Young.

The software programme 'De Zaak Manager' is offered free to all Postbank clients. The subscription rate for 'De Zaak Infonet' is 10 ECU per month. This also applies for 'De Zaak Advice'. Clients who order both 'De Zaak Infonet' and 'De Zaak Advice' pay 15 ECU per month in total.

CASE STUDY 22
THE ING GROUP DIRECT MARKETING APPROACH

The Direct Marketing concept within the ING Group is taken care of by the Postbank. The business clients who make use of this are classified according to their profit contribution to the bank. This process also identifies the development potential for each client. Prediction of the future profit contribution is left entirely to neural network systems. For all segments within the total SME client group, an indication is given as to who are the big and small prospective 'climbers', who are the prospective 'descenders' and who are the 'stayers'. Based on this, the 'leakage risk' is calculated, i.e. change of bank due to change in bank product demand.

On the basis of this identification (group) features are composed, so that the client can be served more effectively to both parties' mutual benefit. Account Management plays a large role here as well, because it offers the possibility to increase profit via cross-selling. Stayers are given the normal service supply (contact only by mail and telephone). Descenders are paid extra attention, especially when they still belong to the most profitable customers. The possible cause of the expected descent is investigated. It may then be possible to take action in time, offering other financial products or transferring to another form of distribution within the ING Group, for instance to the ING Bank for service via Account Managers. ING's aim is to bind the climbers even more to the bank. This now happens increasingly with the same instruments as traditional office network banking, like customer loyalty programmes and personal account management.

Expectations of the Postbank about the Direct Marketing concept run high. At the moment, 25% of the SME market is already served 'at a distance' and the generation of young entrepreneurs is especially enthusiastic about this approach. It is therefore expected that the percentage of Direct Marketing users will increase further because of start-ups and business succession. Research shows that the users find self-service via Direct Marketing more efficient, convenient and cheaper than traditional banking. Nevertheless, direct banking will not bring an end to the office networks, a fact which is also acknowledged by the Direct Banking Unit of the Postbank. Personal contact between client and bank remains indispensable. However, the structure of the bank office networks might well change under the pressure of the costs and the new possibilities of Direct Banking. The present spreading of account managers over the offices leads to under-use of the available knowledge in the larger offices and lack of knowledge in the smaller offices. By levelling the dividing walls between Direct Banking and Service Banking this problem can be solved further. Clients of offices are given the opportunity here to be served via direct banking at times that are convenient for them. Personal contact remains possible, perhaps on a smaller number of occasions, but it is made more effective by a previous electronic exchange of intentions, possibilities and conditions. At the moment, the Postbank is busy making the two distribution channels compatible.

CASE STUDY 23
ADVANTAGES OF BEING A PRESTIGE SME IN PORTUGAL

In 1992, Banco Nacional Ultramarino (BNU) the commercial bank within the CGD-Group, together with IAPMEI, the state agency for support to SMEs, launched an initiative to distinguish SMEs fulfilling certain criteria of excellence. To become a so-called ‘Prestige Enterprise’ the SME entrepreneur must demonstrate good management skills and achieve certain economic and financial ratios. Every year, a commission composed of experts from the two initiators, and with the support of a rating institute, selects firms from BNU and IAPMEI clients to become Prestige Status Members. The announcement of the results is usually made at a public event, in the presence of Members of the Government. The status of being a Prestige SME is valid for one year.

Generally speaking, the candidature for Prestige company is open to SMEs in mining, manufacturing or commercial activities, with annual sales of about 1 million ECU, assets above

1 million ECU, asset ratio above 30% and positive annual profits. In 1992, about 200 companies were selected. Since then the number of Prestige SMEs has grown fast: 381 in 1993, 476 in 1994 and 634 in 1995. About 80% belong to the manufacturing sector and around 70% of the SMEs selected were also selected the year before. On average, turnover and assets are five times higher than the minimum criteria.

The main purposes of the initiative are: rewarding SMEs with the best economic, financial and management performance; obtaining a demonstration effect to other companies, investors and operators; offering better access to capital markets, including incentives; drawing conclusions and making inferences about the annual progress of the economic and financial situation of Prestige SMEs, and making comparisons with the evolution of SMEs in general.

In relation to the bank, the advantages for selected SMEs are as follows:

- immediate personal attention from an Account Manager;
- priority in the assessment of credit requests and a quicker decision-taking process;
- lower interest rates, maximum 2% above the Prime Rate of the bank;
- lower fees and loan guarantee commission (maximum 1%);
- no need for additional rating procedures;
- preference in obtaining information and training courses from the bank;
- free publicity, both in the general media as well as in specialised publications.

CASE STUDY 24
THE SME CLIENT UPGRADING STRATEGY AT CERA BANK

The main spearhead in CERA Bank's new SME policy is systematic extension of the number of High Value Clients (HVA). The bank has two target groups in mind: clients not yet belonging to the group of HVA's and non-clients that could immediately or in the longer run join the HVA's of CERA Bank.

The policy, directed at both target groups, consists of three phases. Phase 1 is selection and preparation. Its basis is the network of 900 offices spread over the country and the Marketing Profit Plan (MPP), which every branch office has. The MPP provides statistics about the potential of SMEs within the work area of the branch office and the degree of relationship with the present clients regarding the nature and the volume of the bank products used. The MPP can give answers to two important questions: is there enough potential in the area for a pro-active acquisition policy towards new prospective clients? and, which products need to be sold to existing clients to raise them up to the status of Higher Value Clients? To help the staff to answer these two questions, the office can also obtain from the head office a list of profitable non-clients in the area and a list of its own prospective clients. The information is made available from various sources within and outside the bank.

Of any potential HVA, whether client or non-client, a 'study' is made in order to examine to what extent he might be of any interest to the bank. For this work, the local staff can count on the help of external experts. These experts, called SME advisors, are in charge of coaching 20 branches each. Together with its SME advisor the staff draws up an action plan. This plan states which non-customers need to be attracted, including starters and growing companies, which clients have to be optimised through higher product sales and which top clients need to be or can be further optimised from a relationship point-of-view. The action plans are put together at regional and national level. They must fit into the national objectives and action for the SME market.

Phase 2 is the implementation of the action plans. In the branch offices, equipped for handling SMEs, approaches to the selected (non-)clients are left to SME Account Managers. On top of the usual 6-month training and at least 3 years of practical experience, the Account Manager gets a 6-day training course in order to be able to deal with CERA's new philosophy. During this course, he learns how to select good SMEs, how to contact SMEs (for non-clients it means for instance getting the assistance of multipliers; clients with good access to non-clients), how to prepare the discussion with a (non-)client, how to hold an open discussion, how to negotiate, how to maintain a good relationship, etc. In addition, the SME advisor who is monitoring the Account Managers receives special training.

The training is based on a philosophy about the different stages in the relationship between bank and prospective SME clients. CERA distinguishes 4 stages of growth in the relationship. The start-up stage in which the demands of the SMEs focus mainly on long-term loans and payment transfers. Secondly the operational stage in which the demands of the clients focus on a wide range of banking products, followed by the take-over stage in which the company is taken over by someone else or another company is taken over by the client. Finally the personal stage, in which the client has accumulated a certain amount of capital and is looking for investment return and asset management. CERA Bank wishes to become a partner to SMEs and run with them through all the 4 stages. The 'total' customer approach therefore has a central place in the concept, based on an intensive relationship rather than on selling products.

Phase 3 provides a structured follow-up to the actions taken in the implementation phase. This means, among other things, providing the branch managers with profit tables, in which they can see the profitability at customer, product and branch level as compared to the situation one year earlier. For interpreting the figures, the branch can call in the support of the SME advisor. When drawing up a new action plan, the figures of the previous year are of course taken into consideration.

CASE STUDY 25
GROUPE BANQUES POPULAIRES' OFFICE PRODUCTIVITY IMPROVEMENT PROGRAMME

The French Groupe Banques Populaires consists of 30 independent regional offices - a central organisation in Paris determines working methods for the associated banks, usually allowing enough leeway for the local management to implement them according to its own specific needs.

Since 1990, the Group has been working on a project to increase the efficiency and effectiveness of the sales organisation with the aim of raising profitability and improving service to clients. Both the general managers of the Chambre Syndicale and the executive managers of the participating banks are involved in this project. The starting point is the private client market and the central concern is improving coherence both within the bank and between banks in order to achieve synergy effects. Results so far have been so good that the project may be extended to cover business customers.

Profitability has increased because the administrative organisation has been improved, procedures overhauled and the interaction between management and offices accelerated. The six banks participating in the experiment use a pragmatic method which is aimed primarily at honing commercial skills - every bank has the chance to compare its position with other banks in the Group and revise its objectives in the light of the result.

Each bank is analysed in six areas: commercial goals, investments in human capital, relation management, application and control of resources, organisation of sales and exploitation of IT for commercial purposes. For these six areas, 25 objectives have been set, based on existing practices in the participating banks and quantified with the aid of ratios. The scores against the ratios form the basis for decisions about the nature and intensity of action which needs to be taken.

The analyses of the situation in the six pilot banks have been compiled into a report and the report offered to the other 24 associated banks via the central organisation, thus giving them the opportunity to identify their own strong and weak points. This permits an assessment of the strength of the group as a whole and highlights any areas where improvement is needed.

The report also outlines best practices of the banks participating in the pilot project. If the commercial organisation is to be improved, management commitment is essential. In the regional banks, the management can adapt the commercial skills mentioned in the report to the specific needs of their clients. It is also important to provide guidelines for account managers by assigning certain standard activities to them and identifying goals.

ANNEXE 2

AN EXAMPLE OF A CODE OF CONDUCT FOR THE RELATIONSHIP BETWEEN BANKS AND SMEs


Lloyds Bank
OUR CONTRACT WITH
OUR BUSINESS CUSTOMERS

INTRODUCTION

We want to provide the highest quality of service to our business customers. This booklet will help you to get maximum benefit from your banking relationship.

In response to a request from our customers to explain our banking services clearly to them we published 'Lloyds Bank and our Business Customers' in 1991.

In this revised version now called 'Our Contract with our Business Customers' we have incorporated many comments both from customers and from organisations representing businesses as to how we might improve understanding.

OUR COMMITMENT TO SERVING YOU

We seek to act fairly and openly in all our dealings with you.

We value your custom and want to ensure that the service we provide is what you need, when and where you need it.

To do this, we take great care at every stage of the relationship: when you first open an account, and throughout the time you bank with us.

We seek at all times to observe the highest standards of:

- confidentiality
- integrity
- accuracy
- reliability

and above all:

- professionalism.

OUR PARTNERSHIP WITH YOU

A good banking relationship is a two-way process. We have duties and obligations to our customers, and they have responsibilities towards us.

What might we ask from you as one of our customers? We like to know how your business is progressing. To make sure we are providing you with the right service, we welcome regular information on the financial health of your business and your future plans.

And if you have any problems we like you to tell us; we are always available to discuss ways of providing support. The sooner you get in touch, the better able we are to help.

TERMS AND CONDITIONS

Written terms and conditions of our services will be expressed in plain language.

We will give reasonable notice of any changes usually a month before these come into effect, giving you the opportunity to discuss them with us if you need to

OPENING AN ACCOUNT

When you open an account, we will explain the procedures, including what documents are needed for formal identification. This is necessary to protect everyone – you, us, and the general public – against fraud and other misuses of the banking system.

We like to discuss your plans with you to gain an understanding of your business, and to identify which of our products and services will be most useful to you.

If you are starting a business for the first time, we provide a comprehensive package of help and guidance, which includes a copy of the 'Lloyds Bank Small Business Guide' and our introductory pack 'Planning It Out'.

If you need more detailed advice or information, simply let us know. We will help, if we can.

CHARGES AND INTEREST

Charges for all our services are advised and agreed with you in advance – either as set out in our Business Tariff, or by individual negotiation.

We publish a standard Business Tariff detailing charges for everyday banking services, such as paying in to your accounts, and drawing cheques. You will receive a copy of the tariff when you first open an account and an updated copy will be sent to you at least one month before any changes are made. Further information is always available at all branches.

We can negotiate an idividual basis for charges with you if this is more appropriate for the type of activity passing through the banking account. Individual arrangements will normally be reviewed annually, and any changes will be agreed in advance and confirmed in writing.

The calculation of basic account charges is shown on your account statements. Any other charges, whether for services not included in the Business Tariff or separately negotiated between us, will be agreed with you in advance.

We shall give you advance notice of service charges before they are deducted from your account so that you can check them, and query anything you do not understand.

Current interest rates are displayed in all branches. When interest rates change – usually as a result of market movements affecting all lenders – it is not always possible to give you notice and new rates may come into effect immediately. Changes are shown on notices in all branches or in press advertisements. Your branch can confirm the current rates applying to your account at any time. Your bank statement will also show the rates in force on the day it is produced.

BORROWING

Borrowing is important for many of our customers and also for us. We are always ready to discuss the borrowing requirements of your business, to see how best we can help.

NEW BORROWING

Borrowing can be arranged in a number of ways. The most common are:

- overdraft – short-term cashflow requirements, e.g. for stock;
- loan – medium-term finance for asset purchase, e.g. for plant and machinery;
- mortgage – longer-term, e.g. for the purchase of business premises;
- invoice factoring – the management of payments due to you from your customers.

If you wish to borrow from us, we need to consider:

- what we know about your business and its track record;
- the amount you want to borrow and for what purpose and, most importantly,
- the ability of your business to meet interest payments when they are due and to repay the money borrowed as agreed.

INTEREST RATES

The rate of interest we can agree will reflect both market rates generally and our judgement of your business strengths including:

- the amount of money we are asked to provide in relation to what you have put into the business;
- the profitability of your business;
- the amount of money passing through your account in relation to the level of borrowing;
- the value of any security;
- the quality of management.

We will agree a basis for charging interest with you, so that you will know how the cost of borrowing will change with market movements. If it becomes necessary to change that agreement we will advise you in writing one month before the new terms come into effect.

WRITTEN AGREEMENT

Once borrowing has been agreed with you, we will confirm the details in writing. This will set out:

- the amount and term of the borrowing;
- the interest rate and when it is charged;
- details of service charges and when they are payable;
- details of any security required, together with any margin of cover that has been agreed;
- any security or administration fees;
- repayment terms and conditions;
- your obligation to provide financial information;
- your obligation to maintain certain agreed financial requirements.

To confirm your understanding and acceptance of the arrangements, we will ask you to sign and return a copy of the agreement.

Overdrafts are repayable on demand but it is normally our intention to make overdraft facilities available for a period of up to 12 months, subject of course, to the terms of your written agreement.

Loans are agreed for a fixed period and are not normally subject to any interim review if the terms and conditions are met. The only exceptions to this are events outside our direct control, such as death or bankruptcy.

KEEPING IN TOUCH

If we have lent you money, we should get together from time to time to check how your business plans are working out. You should be able to provide accurate, up-to-date financial information to help both of us confirm that your business is running smoothly.

Following any reassessment, if there is a need to change the terms and conditions agreed between us we will confirm this for you in writing at least one month before the new terms come into effect. This will ensure there are no surprises.

If we are unable to assist, we will tell you why and explain what needs to be changed for us to reconsider.

Should you experience or foresee difficulties in meeting your commitments, let **your manager know straight away. It is in our mutual interest to help you plan a way forward.**

SECURITY

Sometimes in agreeing borrowing arrangements with you, we will ask you to provide security.

Security can be provided in the form of:

- property or land;
- a life assurance policy;
- stocks and shares;
- a guarantee;
- a debenture over business assets (limited companies only).

We will explain what is required. If a guarantee is involved, it is important for the person giving the guarantee to seek independent legal advice, and to be fully aware of the responsibilities involved.

Borrowing arrangements will normally be unaffected by short-term fluctuations in the value of security, unless otherwise agreed in our written agreement. If security values alter significantly, however, we may wish to review the borrowing arrangements with you.

Once borrowing and any other commitments to the Bank have been satisfactorily cleared, we will release any security held if you ask, although this may not always be cost effective if you want to borrow again.

IF YOU ARE NOT SATISFIED

We aim to provide all our customers with the highest standards of service. However, if things do go wrong, we want to put them right as quickly as we can.

Most problems can be resolved by your branch. Please contact your branch by telephone, or you may wish to visit or write, whichever you prefer.

If your branch does not deal with the problem to your satisfaction:

- Contact the Regional Executive Director. Your branch or our Customer Relations Centre will give you his name, address and telephone number.
- Our Customer Relations Centre can be contacted on 0808 147789 (free for calls within the UK). It is open between 8.30am and 6.00pm Monday to Friday and between 9.00am and 4.00pm Saturday. An answerphone operates outside these hours.
- If the problem has still not been resolved to your satisfaction, you may wish to contact John Spence, Managing Director, Business Banking, whose address is: Lloyds Bank Plc,
  PO Box 112, Cattons Way, Bristol BS99 7LB.

For individuals, partnerships and incorporated bodies with a turnover of up to £1 million, the services provided by the Banking Ombudsman may be available to you. The address is:

The Banking Ombudsman,
70 Gray's Inn Road, London WC1X 8NB
Telephone: 0345 660902

Details of the scheme are available from any branch. The Banking Ombudsman determines which complaints he will consider.

This document forms the basis of the CONTRACT that Lloyds Bank has with its business customers, subject only to its amendment by the specific terms and conditions applying to particular arrangements individually agreed with a customer which will take precedence, and the changes introduced to this document from time to time.

John Spence
Managing Director, Business Banking

Branch Stamp

Manager

ANNEXE 3

PARTICIPANTS FROM THE BANKS AND SME ORGANISATIONS

PARTICIPANTS FROM THE BANKS AND SME ORGANISATIONS

The Members were nominated in their personal capacity and for their knowledge of the issues involved in SME financing.

	Member	Expert	Telephone / Fax
SME Organisations			
CCACC	Mr Herbert KELLNER Délégué général	Mr Rainer SCHLÜTER Délégué général adjoint	T: +32.2.5375740 F: +32.2.5370917
EUROCHAMBRES	Mr. Andreas KYRIAZIS Vice-President	Mr Andreas THANASSOULIAS Délégué permanent des Chambres de Commerce et d'Industrie Helléniques auprès de la C.E.E.	T: +32.2.2310715 F: +32.2.2300038
EUROCOMMERCE	Mr. Roger VANDENABEELE Administrateur délégué, HOBO/FAAM NV	Mr Colin LUSTENHOUWER Vice-President	T: +32.2.2305954 F: +32.2.2300078
EUROPMI	Mr Brian PRIME President	Mr Blando PALMIERI Secretary-General	T: +32.2.2306477 F: +32.2.2306704
UEAPME	Mr Stan MENDHAM Chairman, The Forum of Private Business	Mrs Brenda MENDHAM Special Projects Manager, The Forum of Private Business	T: +44.1565.634467 F: +44.1565.650059
UNICE	Mr. Pierre SOLE Administrateur délégué, SA Alexandre	Mrs Marie-Laurence BUISSON Ms Sheila O'SULLIVAN Adviser, Industrial Affairs	 T: +32.2.2376511 F: +32.2.2311445
YES FOR EUROPE	Mr. Didier LIVIO President	Mr Frédéric SOUDAIN Secrétaire général	T: +32.2.2191225 F: +32.2.2193215
Commercial Banks			
Bank of Ireland **IRL**	Mr Howard KILROY Governor	Mr Barry McNAMARA Head of Enterprise Support Services	T: +353.1.6615933 F: +353.1.6763493
Banque Générale du Luxembourg **L**	Mr Marcel MART Chairman of the Board of Directors	Mr Marc HENTGEN Head of the Corporate Banking Department	T: +352.42425104 F: +352.42425141
Commercial Bank of Greece **EL**	(9/95-6/96) Mr Panagiotis POULIS Chairman, Board of Directors (6/96-2/97) Mr Costas GEORGOUTSAKOS Chairman, Board of Directors **Co-chairmen of the Round Table**	Mrs Stella KOVLAKA Sector Manager on European Affairs	T: +30.1.3284177 F: +30.1.3311781
I.N.G. Bank **NL**	Mr Marinus MINDERHOUD Member of the Board	Mr Jan BEZEMER Head, Group and Franchise Finance	T: +31.20.6522993 F: +31.20.6522997
Mediocredito Centrale **I**	Prof. Gianfranco IMPERATORI President	Mr Jean-Bernard PIEDBOEUF Representative, Brussels Office	T: +32.2.6469616 F: +32.2.6403897
National Westminster Bank **UK**	Lord Alexander of WEEDON Chairman	Mr Ian PETERS Head of Retail Marketing & Sales	T: +44.171.4542852 F: +44.171.9201106

	Member	Expert	Telephone / Fax
Savings Banks			
Bikuben Girobank **DK**	Mr Henrik THUFASON Chairman of the Board of Directors and Chief Executive Officer	Mr Louis FALLOV Head of Relations, Treasury and Asset Management	T: +45.43305005 F: +45.33937015
Caixa Geral de Depósitos **P**	Mr João Maurício FERNANDES SALGUEIRO President	(9/95-6/96) Mr José CORREIA PEREIRA Financial Analyst / Economist	
		(6/96-2/97) Mr Carlos MATTAMOUROS RESENDE Technician	T: +351.1.7905033 F: +351.1.7905743
Stadtsparkasse Dortmund **D**	Mr Helmut KOHLS Vorstandsvorsitzender	(9/95-4/96) Mr Wolfgang BEYER Direktor - Hauptabteilung Internationales Geschäft, Stadtsparkasse Düsseldorf	
		(5/96-2/97) Mrs Irmtraud LUX Referentin, Deutscher Sparkassen- und Giroverband	T: +49.228.204319 F: +49.228.204725
Swedbank **S**	Mr Lars-Erik KVIST Executive Vice-President	Mr Sotiris DELIS Vice-President	T: +46.36.196805 F: +46.36.168948
UNICAJA **ES**	Mr Braulio MEDEL CÁMARA President	Mr Luis MARTINEZ SANCHEZ Representative, CECA	T: +32.2.2194940 F: +32.2.2193578
Co-operative Banks			
CERA Bank **B**	Mr Willy BREESCH Chairman of the Executive Committee	Mr Eric de VOS Directeur adjoint	T: +32.16.304280 F: +32.16.303205
Groupe Banques Populaires **F**	Mr Jacques DELMAS-MARSALET Président **Co-chairman of the Round Table**	Mr Patrick CARBONNEL Délégué permanent auprès des institutions européennes	T: +32.2.5131459 F: +32.2.5110346
		Mr Yvan de la PORTE DU THEIL Directeur Central, Marché PME-PMI	T: +33.1.40396905 F: +33.1.40396060
OKOBANK Osuuspankkien Keskuspankki OY **SF**	Mrs Helena WALLDÉN Executive Director	Mr Ville JUMPPANEN Manager, Corporate Finance	T: +372.6.266491 F: +372.6.266494
Österreichische Volksbanken **A**	Mr Robert MÄDL Vorsitzender des Vorstandes	Mag. Alois LINDNER Directeur Magister, Volksbank Salzburg	T: +43.662.86964200 F: +43.662.86963165
Rapporteur			
Stichting Toekomst Middelgroete ond Kleine Ondernemingen (STMKO)	Professor Dr. Leo VERHOEF		T: +31.40.2473841 F: +31.40.2465949
Secretariat			
European Commission DG XXIII	(9/95-6/96) Dr Reinhard SCHULTE-BRAUCKS (6/96-2/97) Dr Albrecht MULFINGER Mr Jeremy HEATH	Head of Unit Head of Unit Administrator	T: +32.2.2960940 F: +32.2.2952154

ANNEXE 4

RISK ASSESSMENT FORM DEVELOPED BY THE FORUM OF PRIVATE BUSINESS

FORUM OF PRIVATE BUSINESS'S RISK ASSESSMENT FORM

THE CO-ORDINATED STRENGTH OF INDEPENDENT ENTERPRISE

Questions 1 to 5 deal with a measure of your current business and the quality of your borrowing proposal. No measure has been or could be made of this but you and your bank may want to do so.

1. How much do you want to borrow? £

2. What will the money be used for?

3.

Type of Business	
Sales Turnover	
Number of Employees	
Profit as % of Sales	
Gearing	

4. Location

5. Do you have a cashflow forecast which shows that the money can be repaid? Yes ☐ No ☐

If "yes" Over what period do you expect to repay the borrowing? months
(NB - overdraft has to be repaid)

If "no" What proof do you have that you will be able to repay the borrowing?

Questions 6 to 11 will be "scored". Your bank may have a different view from yours. They may have a different measuring method. But what matters is that you discuss to agreement some logical and repeatable measurement of risk to determine your "Risk Score". The "Risk Score" table shows different ranges of interest rates. Your bank may legitimately disagree with these. Again the only thing that matters is that you and your bank discuss them to agreement. Ideally on some logical, repeatable method so that as your risk score changes, as it will, the interest rate fluctuates with it.

6	What is your past business experience?				Max per person	Borrower	Key Staff No. 1	Key Staff No. 2
Years in business								
Range	0 - 1	1 - 2	2 - 4	4+				
Score	1	2	4	6	6			
Turnover of business								
Range	<£100K	<£300K	<£500K	£500K+				
Score	1	2	4	6	6			
Profitability								
Range	< 5%	< 0%	< 5%	5%+				
Score	0	2	4	6	6			
Gearing								
Range	1 : 1	1.5 : 1	2 : 1	4 : 1				
Score	1	2	4	6	6			
Position								
Range	Owner/MD	MD	Director					
Score	8	5	3		15			
Experience								
Range	Finance	Mktg/Sales	Admin	Technical				
Score	5	5	5	5	20			
Sub-total per individual					60			

	Max Score	Your Score
Business Experience	180	

NOTES OF EXPLANATION

If in doubt, call MIS on 01565 634467

INTRODUCTION

We have just come out of recession. The banks lost a lot of money lending to small businesses in the late eighties/early nineties. Most of us can't grow from retained profitability.

All these statements mean that we, as small business owners, need to improve our case to the bank when we need to:

1. make sure we are able to borrow the money we need.
2. make sure we feel secure that the bank will not reduce or remove the lending.
3. to ensure we pay the right level of interest.

The FPB's Risk Assessment Form is only a guide. Many bankers will have different ideas. But it will help you to understand the risk so lets get started!

Question 1

Record here the amount of money you want to borrow.

It would be unusual if this was not accompanied by a Business Plan and/or Cash Flow Forecast to prove the amount of borrowing is 'right' and that it can be repaid.

Question 2

Record here what the money will be used for. The more specific the better. Banks and all other financiers lend by overdraft facility for working capital and term loans for capital expenditure.

Other forms of finance that need to be considered are HP and leasing.

Question 3

Give a brief description of your business. This will help the bank and you to see the borrowing in its true light.

$$\text{Gearing is} \quad \frac{\text{FIXED ASSETS}}{\text{TOTAL BORROWING}}$$

Banks like this ratio to be 1:1 or more.

Question 4

Location - more than address. Add other relevant information if you consider it will affect the bank's attitude to your business.

Question 5

Banks like to see repayment periods of less than 10 years for loans and 3 years for overdrafts.

It may be that you have a simple way of showing your ability. If so use it. Generally these simple measures are best.

Question 6

Banks want to be sure that you can manage a business. No matter how hard you state what you <u>will</u> be able to do, what you have <u>done</u> cuts more ice!

- A How long have you and your top team been involved with business? The longer the better.
- B The higher the turnover the better, but not if the business was unprofitable.
- C The higher the profit the better.
- D The lower the gearing the better, see question 3 for definition.
- E The more important the position the better.
- F The wider the experience the better.

Now score yourself as owner/borrower and your next two key staff.

From the bank's point of view if the borrower is the only experienced member of the team then the risk is so high that you might be expected to provide insurance cover on your life to repay the bank.

Do not be too concerned if your score in this question is low because as you grow you will be able to improve it.

Question 7

What matters most about your past experience is how successful you were. Again, what you have done is more important than what you say you are going to do.

You will need proof here. The only way is accounts.

Question 8

This question sets out the whole spectrum of management control information and it is unlikely that any small business will score maximum marks.

However, if your score is low in other sections, it is a way of reducing the risk. Why? Because if you are the person lending the money you might have the same feeling as the bank. Can this person manage the money I am lending so I can be sure I will get it back?

You might be surprised to see a weekly requirement. The Gross Income, Gross Expenditure, Aged Debt, Aged Creditors and Bank Reconciliation are all very easily found from your own books and in tough times the most successful businesses do this.

What is "Your Own Business Measure"? Many businesses find that there is one measure that tells them it all, e.g.

Number of covers per day in a restaurant
Number of sales and number of jobs in retail
Sales production per hour in manufacturing

Of course you will need to convince your bank but if your measure is accurate you will.

Question 9

Of course it is one thing to have the information yourself but are you prepared to show it to the bank in good and bad times?

Some small business owners believe the less you tell the bank the less they will have against you.

But nobody likes surprises about lending and borrowing money. If you can survive tough times you are a better risk. So keep the bank informed.

Question 10

When we, as employers, employ people we make assessments about the character of new staff. There is no mystery, so does the bank.

Question 11

Simply, can you work with the bank, can they work with you? It is clear if you can't work together, no matter how high the score, it will not work. Hence the -400 points.

Question 12

The above risk assessment is all based on the success of the business - but businesses can, and do, go wrong. SO you need to consider the vulnerability of your business in relation to your personal assets.

1. What if you lose your key partner or employee?
2. How wide is your customer base? How many eggs do you have in your basket?
3. What if you suffer a large bad debt?
4. What if you fall out with your banker?

The usual way to offset these vulnerabilities is to consider an escape route - the route you will be able to take to protect yourself and your family.

So if you intend to borrow £X, where could you find this £X to repay the bank? Would you

1. Repay from savings?
2. Sell your assets - Business assets - Building - Plant - Stock - Etc
   Personal assets - House - Jewellery - Etc
   Insurance - Sell policies

Banks call this escape route "security" and if you pass some of this security over to the bank you should expect the bank to recognise a reduction in risk and hence a reduction in the margin. Of course the quality of the security will be an important factor i.e. cash savings are ideal but the fluctuating resale value of stocks is not as good.

Score Index

Having made your score see what index your ZPR Risk Assessment has given it. Then read across to find the correct rate band. The banker may not, and probably will not, agree with either. Does that matter? No, be prepared to discuss it to agreement.

Then you will know how the bank measures the risk and what you can do to improve the risk. Improve the risk and the bank should charge you less interest. The bank should have a lower bad debt and hence more profit. Everyone is happy.

7	What has been the overall trend? Or have you proved your ability to make your plans work?				Max Score	Your Score
Range	Very Positive	Positive	Stable/ Unproven	Erratic Decline		
Score	20	10	5	0	20	

8	What is your management control information?	Max Score	Your Score
Accounting			
Weekly	Gross Income & Expenditure, Aged Debtors & Creditors, Bank reconciliations	10	
Monthly Profit & Loss		10	
Quarterly	Profit & Loss, Balance Sheet	10	
Annual	Audited Accounts, Bank Report	10	
Financial Management			
Business Plan		10	
Cash Flow		10	
Budget		10	
Three Year Plan		10	
Sub-total		80	

As an alternative to Question 8, you and your bank may be able to agree a simple yardstick of your business, such as number of sales or jobs per day, or a clear understanding of your "break-even point", which is just as accurate as the above.

9	What will you show the bank? (Or the alternative measures agreed in question 8)				Max Score	Your Score
Accounting	Week	Month	Quarter	Annual		
Score	10	10	10	10		
Financial	Bus. Plan	Cash Flow	Budget	3 Year Plan		
Score	10	10	10	10		
Sub-total					80	

10	Character of Borrower - Stability and Dependability				Max Score	Your Score
Range	Exceptional	Above Average	Average	Below Average		
Score	20	10	5	0	20	

11	Will we be able to work together?					Max Score	Your Score
Range	Very Well <------			------> Not Very Well	Not At All		
	1	2	3	4			
Score	20	10	5	0	-100	20	

12	Your Escape Route or Banker's Security		Max Score	Your Score
	Resale value of security	EX		
	Amount of Borrowing	FY		
		Grand Total	400	

If the ratio EX/FY is more than 1.5 the risk score index should be reduced by at least 1

RISK SCORE TABLE

SCORE INDEX	SCORE	INTEREST RATE OVER BASE
1	300 - 400	1.5%
2[*]	250 - 300	1.5%
3	200 - 250	1.5% - 2.5%
4	150 - 200	2.5% - 3.5%
5	100 - 150	3.5% - 5.5%
6	50 - 100	5.5% - 7%
7[**]	0 - 50	over 7%

[*] [illegible]
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