Wednesday 29th April 2020

Mark Pawsey MP
Chair
Business, Energy and Industrial Strategy Select Committee
House of Commons
London SW1A 0AA

Dear Mr Pawsey,

BEIS SELECT COMMITTEE ENQUIRY ON THE IMPACT OF CORONAVIRUS ON BUSINESSES AND WORKERS: A WRITTEN SUBMISSION FROM THE ASSOCIATION OF PRACTISING ACCOUNTANTS (APA)

Introduction

1. The APA is a network of leading business advisory firms meeting the needs of the real economy from SMEs to AIM companies.

2. As Chairman of the group I have seen first-hand just how challenging the impact of Covid 19 has been on the 14,000 typically owner managed businesses our Members advise and support.

3. Research we carried out among more than 1000 of these entities between the 15th and 23rd April suggests that the next 12 weeks will be critical to the survival of many. In particular:

   - One third has seen turnover reduced by 70% or over since the lockdown
   - Nearly half have seen turnover reduced by 50%
   - 60% have less than 12 weeks cash in the bank
   - 40% have less than 8 weeks cash in the bank
   - A majority of businesses have used the Government's Job Retention Scheme of whom 89% regard it as 'critical' to their ability to keep staff.
   - Only 16% of respondent have applied for funding under CBILS of whom two-thirds said the scheme needed to work better. We conclude from this that others may have applied had it been communicated / implemented more effectively by lenders.

4. Many of the businesses we help were thriving going concerns until Covid-19 struck. They will also be vital to kickstarting the economy once the immediate crisis has passed. That is why it is vital Government provides evidenced based support where it is most needed.

5. This is not just about the next three months (critical those these are), but Q3 and Q4 where the challenge will be to get businesses up and running again. Unless these entities can generate profit quickly, they will struggle to pay back the loans they are currently receiving.

6. What is clear is that for most, an immediate return to 100% pre-coronavirus turnover once the lockdown has been eased is just not realistic. If the return to normality takes longer then the effect on the majority of businesses is not sustainable in the medium term.

7. The UK Government has said it will do whatever it takes to help the country pull through. Over recent weeks there have been a raft of measures that have been introduced to help support businesses which have been very welcome. Where we have criticism of these initiatives it is generally around the communication or execution rather than the principle.

8. We note there are no formal terms of reference for this enquiry. This short submission draws on our own quantitative research[1] as well as anecdotal evidence to help the Committee understand the plight of owner managed businesses.

9. We have previously given oral evidence to your Committee and would be happy to do again as part of this enquiry. The immediate sustainability of the UK economy is at stake which means the policy response has to work.

The overall impact of Covid-19 on the owner managed sector

10. These are exceptional times not just for businesses but the country as a whole. The challenge will be to get the owner managed sector through the immediate crisis and back up and running in a way that enables the many thousands of people this sector employs to return to work safely. This is not a binary choice between the economy and public health. Both priorities need to be managed strategically and in tandem.

11. Research the APA carried out in the second half of April suggests there are three immediate challenges facing owner managed businesses:

    - Cash flow constraints. The majority of these businesses have seen a significant slow-down in cash inflows limiting their ability to operate.

    - Legislative challenge. While Government interventions (including CBILS and JRS) have been welcome, poor communication and faltering execution have meant many businesses have incurred additional costs and struggled to plan their cash flows and manage their day to day operations effectively. For example, repurposing your payroll team to deal with furloughing staff while at the same time trying to negotiate terms with lenders under CBILS diverts significant time and resource from BAU activity. That is why it is vital Government makes these processes as simple and user friendly as possible.

[1] We have shared some of the headline findings with the FT

- Uncertainty as to when things will return to normal. While we recognise that the new normal may well be very different, the more that can be done to help businesses anticipate what this looks like the better able they will be to put in place the operational and financial planning that will be vital to their recovery.

12. Covid-19 is also impacting certain sectors disproportionately. For example, the loss of footfall across leisure and hospitality had made the current crisis all the more acute for this sector. We see manufacturers trying to innovate their way out of the crisis (with mixed success). The IT sector faces an increase in demand for home working solutions off set by the significant number of staff who have been furloughed. Professional services are under increased cashflow pressures because they are often seen as the easiest suppliers to stretch.

13. We are particularly concerned about the self-employed with historic average profits greater than £50k, but whose income has now dropped to low levels or even zero. These people still have mortgages to pay and other commitments to meet. Moreover, there is an obvious inconsistency with the employed sector where higher earners can still be furloughed and their employers funded for 80% of that salary (subject to the £2500 per month cap). For micro businesses who may only have one Director who is also employed by the company it is unclear how they can benefit at a time when clients or customers may have dried up.

14. The bottom line here is that overheads do not stop, rent, insurance, security, IT, lease payments, staff who cannot be furloughed, support staff, utility costs, rates etc. If a business generates 10% of turnover profit pre-tax, which is a very good return for most SMEs, and their gross profit is 40% of sales then a fall in turnover of 20% means break even. Our research suggests that a third of owner managed businesses have seen turnover drop by upwards of 70% which is just not sustainable.

    For “people businesses” rather than retailers / manufactures etc the effect is even more dramatic, a 10% fall in turnover will make the business loss making within weeks.

Access to finance

15. The recent Government decision to underwrite 100% of loans for SMEs up to £25k is welcome but we remain concerned that many businesses are struggling to deal with CBILS.

16. Our qualitative analysis of the 16% of owner managed businesses to have taken up the scheme suggests that over three quarters of these entities are frustrated by the scheme with confusion over lending criteria and frustration at the time it takes to get funding in place the two main criticisms.

17. More broadly it is clear that access to finance remains a real struggle for many as the following verbatim examples from APA Member firms illustrate:

    - “Many of our clients have applied for CBILS but so far there have only been a handful of success stories as many are still going through the application process. These are growing businesses some of which were previously profitable but have all been adversely hit by COVID-19. The process to get a decision is very slow and there is mixed feedback on the information being requested. One client was asked for additional information 2 weeks after making their original submission. They have also been asked to reforecast twice."

- "I have a client who has significant negative profit and loss account reserves going back several years. The company - which provides products to the construction sector - has been profitable for the last 3 years. They approached HSBC at the beginning of the crisis who told them to apply for the CBILS loan. They also have a loan from UK Steel Enterprises (UKSE). UKSE recently highlighted to the company that they would not be eligible for CBILS as there is a rule such that at 31 December 2019 if the brought forward losses on the balance sheet are greater than 50% of share capital it means the company is ineligible. HSBC did not tell the company this and it was several weeks later before this was communicated. Banks need to be clear earlier in the process on ineligibility criteria. Moreover, viability should be assessed on a case by case basis - in this instance the company is viable, profitable and could service the debt when we return to business.

- "Clients who are eligible have been appreciative of the £10-25k Grants based on rateable values and sectors. It is welcome that these have started to be paid out in good volumes by local Authorities."

- "We have a client in the construction sector, providing raw material who are in a re-banking process. Whilst eligible (on paper) for a CBILS loan the moving bank position they were in has meant they are currently unable to access the scheme."

- "We have a client in the hotel industry who bank with a challenger bank not yet a CBILS provider. As such the client has struggled to access funds."

- "We have a client in the automotive sector who have secured two lines of asset backed lending outside of CBILS based on the availability of security and debenture, i.e. challenger banks have provided finance where appropriate security is available."

- "We have several clients who have had CBILS applications returned for further information. This is reflective of the fact that requirements of funders have not been clear.

- "Where CBILS is being used, it is taking time to deploy, time which many businesses do not have. The guidance from British Business Bank is that the Company should remain liable for the loan; this is covered by the debenture security. To extend this further to tie in the owners seems completely outside the spirit of the announced support and is unfair to the business owners."

- "We feel that CBILS should be being deployed first, with no PG and with minimal fuss – the credit underwrite should only focus on pre-Covid-19 viability and the turnaround plan. In doing so, the money would hit the market quicker and the businesses would be supported and importantly feel supported. There needs to be intervention to make this change happen as there is a risk the past reputation of the Banking sector will return after it taking 10 year to try and rebuild."

- "There is a real economic risk of a number of businesses failing as the market turns and growth returns. Cash buffers will have been used to fund losses and therefore will not be available to support working capital absorption and the later payment of VAT and PAYE; whilst a future problem, this could see the need for a CBILS 2 model later in the summer.

- "We have spoken to many businesses who were in the process of raising funds before the pandemic, and where these discussions have largely now fallen away. One option might be for Government to introduce measures to include angel investors as part of their lending schemes – who are a hugely valuable part of the funding ecosystem – enticing them back to the table."

18. We would be happy to share other examples with the Committee. What is clear is that a 'one size fits all' approach means that some companies that under normal circumstances would be considered perfectly viable businesses are falling through the cracks.

The Government's Job Retention Scheme

19. The research we carried out in April suggests that the ability to furlough staff has provided a lifeline for many owner managed businesses. Of the 56% of respondents who have taken advantage of the scheme 89% say that it has been critical to their ability to keep staff on.

20. However, as with other Government initiatives, there remain a number of questions around execution where greater clarity from policy makers is needed:

    - How do you determine average earnings for a zero hour/flexible employee?

    - How do you choose who to furlough?

    - How quickly will businesses receive the furlough grant money?

21. While these questions are operational matters for each business, greater clarity in terms of Government advice here could help take pressure off hard pressed owner managers who are grappling with the intrinsic links to cashflow and future viability.

22. There is also real concern that if the scheme is not extended beyond its current term businesses will need to introduce redundancies and pay cuts losing good people through circumstances beyond their control.

23. It is also worth noting that furloughing only covers staff who are doing nothing for the business – many (perhaps most) employees are needed for something but cannot be furloughed so 100% of cost remains with the business.

24. Across many sectors including the professional services sector median salaries can often be higher than £30k. Many employers are paying staff 100% of full salary at which point 80% represents maybe 50% of cost. Employers need to continue at these salary levels because of the need to retain goodwill and continuity. Poorly treated staff who leave post lockdown only damage these businesses further.

Going concern issues

25. Because the material impact of Covid-19 takes many of our clients into uncharted territory it has become significantly more difficult for our audit teams to make going concern judgements about future operating viability. The sorts of questions we are wrestling with at the moment include:

- What are the likely adverse impacts on cash flows to the end of July 2020?
- Have management teams been realistic in their 13-week forecasts?
- What is the likely receipt of available government schemes, e.g. CBILS?
- When is it likely that business at usual will return?
- What might the impact of a phased return look like?
- What is the known financial position of key customers and suppliers?

26. There is a need to recognise that many of the judgements we will be making over the coming months will be in response to exceptional circumstances. Not all of these will be accurate. Notwithstanding recent guidance from the regulator more needs to be done to publicise this issue and agree how it should be handled.

Other observations and recommendations

27. We hope the following verbatim points from APA Member firms and their clients may also be useful in terms of your enquiry:

Planning for the medium term.

“The majority of owner managed businesses we are working with have this concern; they are focused on managing the short term impact of COVID 19 (in the main cash flow) but are equally concerned that there will be a time lag between the lifting of lock down and consumer/customer spend returning.
We have yet to see many owner managed businesses formulating plans for this medium term impact. This reflects the fact that they are currently managing their immediate business needs which are changing rapidly as their customers circumstances evolve.”

Salary sacrifice schemes.

“It’s a real issue that the portion of an employee’s contractual salary is excluded from salary for purposes of calculating furlough payments. The government encourages people to provide for themselves with private pensions, then those who do so suffer. We have one employee whose contractual salary is £4800 per month of which £1800 is paid in cash and the rest goes in his pension pot. So the furlough rules mean he gets 80% of £1800 = £1440 instead of the £2500 cap. Government seem to justify this on the grounds that it is excluded from taxable pay, but the tax is just deferred – income tax is payable on the pension which gets paid after retirement. Admittedly, this is an extreme example, but the principle is just plain wrong."

Credit insurance.

"Our credit insurer has cancelled cover on our biggest customer. They give as a reason: 'published financial statements too old for underwriting decision' but it looks like just an excuse to me. That customer has a November year end, so the last published accounts are Nov 2018. The Nov 2019 accounts aren't due for filing until Aug 2020. If they had been filed already, it still wouldn't tell the insurer anything about the elephant in room: the impact of COVID-19 on that company. In France, the government has given some guarantees to allow credit insurers to keep credit limits in place. The UK should follow suit."

Business rates for shared office buildings.

"We rent an office in in Birstall, part of a larger office building, occupied by many tenants, with the business rates being included in the rent. In this scenario, we don't qualify for the relief we would get if we had a stand-alone office of the same size."

Consumer spending

"Many businesses have refocused on digital and online offerings and there are many stories of growth in these revenue streams. However, uncertainty remains as people will only be feeling the effect of reduced pay this month onwards and so online transactions are expected to potentially reduce as people adjust to less income."

FCA Regulated Business.

"Our bankers, Barclays, have told us that when they separated their business into two, Barclays Bank plc and Barclays Bank UK plc and moved us to Barclays Bank UK Limited. Barclays Bank UK plc are not granting CBILS loans to FCA Regulated Business, they comment that we are otherwise credit worthy but as we are in the wrong element of Barclays they have refused us finance."

Landlord

"Our landlords have refused to reduce the rent despite the building being unoccupied. They have yet to consider deferred payment. It is not yet known when we will be able to occupy our central London offices nor the level of occupancy. This is a material overhead which we cannot afford and could cause us to become insolvent. It is particularly galling where the landlord is based off-shore."

Lenders withdrawing facilities.

28. The owner managed sector helps drive jobs and growth across every sector of the UK economy. Right now, this sector is facing its toughest set of challenges in a generation. What I hope this short submission has been able to demonstrate are some of the practical challenges our clients face. Policy makers need to respond with urgency and precision if many of these entities are going to survive.

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