researchnote

Funding worries hit business outlook

Credit is clearly the issue of the moment. The number of commentators pointing to the Western countries' over-reliance on debt as the main culprit for the current economic crisis grows every day. Much of the criticism is aimed at "irresponsible" lending (or borrowing) which occurred as the economies around the world feasted on years of uninterrupted growth. Due to the links between financial markets around the world, what started as a cough in the US sub-prime mortgage market became a global pandemic which has slowed the flow of liquidity to a trickle. And since business ambitions are firmly connected to the ability to borrow, the crisis in the credit market has translated into a change in the general business outlook.

East & Partners' analysis for the latest PricewaterhouseCoopers Private Business Barometer is a potent reminder of the importance of credit conditions for business outlook. The analysis is based on direct interviews with a natural sample of 750 private businesses turning over between $10 and 100 million per annum; a segment traditionally known for its bullish attitude and resilient entrepreneurial spirit.

The early effects of the credit crunch, such as the impact on the availability and cost of debt, which businesses reported in February this year, have become magnified during the six months to August when the latest interviews took place. The strong influence of the credit crunch is illustrated by the fact that some of the most growth-hungry businesses are now feeling the effects of the funding squeeze.

A key indicator which has been shaped by the fallout from the credit crunch is the investment appetite among private businesses. The share of businesses reporting no major investment plans for the next year rose to 56.8 percent in the latest Barometer, a significant increase from 45 percent recorded in February this year. This decline in the appetite for major investments coincides with a weakening in one-year sales and profit growth targets.

Funding challenges are without doubt the main influence on the cooling appetite for business investments and the weaker one-year outlook. A quarter of businesses in the A$10-100m turnover segment say that the availability / cost of debt is the main constraint on capital expenditure, while 66.8 percent of businesses see the availability of debt as the most likely impediment to meeting their targets in the coming year. Fearing imminent tightening in the lending criteria, about 18 percent of businesses say the terms of credit are likely to hold back their growth.

Even the optimistic businesses which remain committed to major growth initiatives face uncertainty on the issue of funding. Capital constraints have become the number one hurdle faced by businesses looking to expand overseas and one in five businesses which are looking to undertake major investments are unsure about where they will obtain the necessary funding.

Changes in the funding mix

As some funding options disappear or start to look too expensive, the funding mix of the businesses which are looking to expand is evolving accordingly.

Among the 43.2 percent of businesses which are looking to undertake major investments, banks have emerged as the single largest source of funding. In other words, the strategic value of a close banking relationship is growing. Reaching out to existing shareholders remains a popular supplementary source of funds, with about a quarter of businesses aiming for a blend between shareholder and bank funding.

With economies around the world remaining in the grip of the credit crisis, private businesses in the A$10-100m turnover segment are becoming more conservative in their outlook for the next year. But many businesses are still looking to expand. However, even the more bullish businesses which are looking to invest and grow are now being forced to re-assess their funding options. Consequently, as businesses start to investigate the different funding options available to them, an opportunity for increased dialogue with their providers and advisors looks set to follow. Banks will therefore become an even more needed partner for private businesses looking to navigate through the current market conditions.

Potential Impediments to Meeting Targets in the Next Year