

**STRENGTHENING LOCAL ECONOMIC CAPACITY
FINAL REPORT**

THE MICRO ENTERPRISE LOAN FUND

now trading as

FIRST BUSINESS FINANCE PTY LIMITED

(a subsidiary company of the sponsors:

Eastern Suburbs Business Enterprise Centre Limited

Botany Enterprise Development Agency Limited)

AUGUST 1995

VERSION: AS PRESENTED TO LGSA

**PRESENTED TO THE
LOCAL GOVERNMENT & SHIRES ASSOCIATION OF NSW**

INDEX

Section 1 EXECUTIVE SUMMARY	1
<i>MELF Achievements</i>	<i>1</i>
<i>Critical Assessment</i>	<i>1</i>
<i>Conclusion</i>	<i>2</i>
Section 2 FIRST BUSINESS FINANCE OVERVIEW	3
<i>Introduction</i>	<i>4</i>
<i>Company Structure & Funding</i>	<i>5</i>
<i>Who provides the finance?</i>	<i>5</i>
<i>The Guarantee Account</i>	<i>5</i>
<i>Profile of an Eligible Borrower</i>	<i>5</i>
<i>The Referral Network</i>	<i>6</i>
<i>Representative Offices</i>	<i>7</i>
<i>Relationship with the credit provider</i>	<i>7</i>
Section 3 INITIAL EVALUATION OF FBF	8
<i>Performance against Benchmarks</i>	<i>9</i>
<i>Profile of people who Got Loans</i>	<i>9</i>
<i>Security Offered</i>	<i>9</i>
<i>Applicant Employment History</i>	<i>10</i>
<i>Analysis of Client Flow</i>	<i>10</i>
<i>Success Rate By Sex</i>	<i>10</i>
<i>Conversion Rate</i>	<i>11</i>
<i>Termination Characteristics</i>	<i>11</i>
<i>Turnaround Time for Credit Decisions`</i>	<i>12</i>
<i>Conclusions</i>	<i>13</i>
Section 4 PROJECT CHRONOLOGY 1993 - 1994	14
Section 5 METHODOLOGY	18
<i>The experience of a Business Enterprise Centre</i>	<i>18</i>
<i>Why Won't Banks Lend to This Market?</i>	<i>20</i>
<i>If New Businesses Fail, Won't New Borrowers Default?</i>	<i>22</i>
<i>Even Dwarfs Start Small - who will benefit?</i>	<i>24</i>
<i>Different Shoes In Other People's Footsteps</i>	<i>27</i>
<i>Is Debt Finance Appropriate to This Market?</i>	<i>29</i>
Section 6 PROJECT MANAGEMENT PROCESSES	30
<i>Summary of Contracts Made</i>	<i>32</i>
Section 7 A CRITICAL SELF-EVALUATION	33
<i>Delays</i>	<i>33</i>
<i>Insurances</i>	<i>33</i>
<i>Legal issues</i>	<i>34</i>
<i>Operating Costs</i>	<i>34</i>
<i>Facilitators Can't Be Lenders</i>	<i>34</i>
<i>The Million Dollar Question</i>	<i>35</i>

APPENDICES

Appendix A	The First In-House SLEC Paper
------------------	-------------------------------

EXECUTIVE SUMMARY

The intention of this project was to create a unique service which facilitated small sums of debt finance to micro-businesses on a commercial basis. Our goal remains to build a commercial portfolio of loans which, for the first time in Australia, will be statistically assessable.

By 30 August, \$300,000 has been lent to 36 businesses in Sydney over nine months. The project is 90% ahead of lending targets for 1995.

The second phase, to replicate the model, is about to be launched in the Hunter Region and a credit provider has dedicated up to \$500,000 for this pilot.

INTRODUCTION

This report charts the history and development of the "Micro Enterprise Loan Fund" project (MELF) sponsored by the Eastern Suburbs and Botany Business Enterprise Centres (the Sponsor) under the Commonwealth Government's Strengthening Local Economic Capacity Program (SLEC). The paper is presented to the Local Government and Shires Associations of NSW as part of the Sponsor's obligation under its SLEC contract.

ANALYSIS OF MELF'S ACHIEVEMENTS

On 30th June 1995 the portfolio of loans was evaluated. The following is a summary of achievements:

- ⇒ 123 clients had been dealt with, requesting loans to the value of over \$1 million
- ⇒ 30 loans had been approved or drawn down to a value of \$244,000
- ⇒ the average size of loan has been \$8,133
- ⇒ nineteen borrowers, or 63%, were unemployed or on the Commonwealth Government's New Enterprise Incentive Scheme for unemployed people.
- ⇒ the approval rate as a proportion of total credit decisions was 64%
- ⇒ no "bricks and mortar" security has been taken by the credit provider

CRITICAL ASSESSMENT OF DEVELOPMENT AND OPERATIONS

This evaluation, and our self assessment of the MELF process, has highlighted some areas of difficulty both in the development of the service and in its operations:

- a number of factors both internal and external caused delays in the development phase of the SLEC project, these included government administration processes

- the operating costs were under-estimated, particularly with reference to the human resources required to successfully operate the facility
- it is clear that the medium term goal of FBF itself becoming commercially viable will take longer than anticipated. Further subsidy will be required, and the fee structure may have to be revisited
- the ultimate goal, to prove that lending to micro businesses is commercially viable for credit providers, will take time to establish. We believe that the portfolio will have to grow to 100 loans, or \$1 Million in loans, prior to this assessment being made

CONCLUSION

Without SLEC, First Business Finance would not exist.

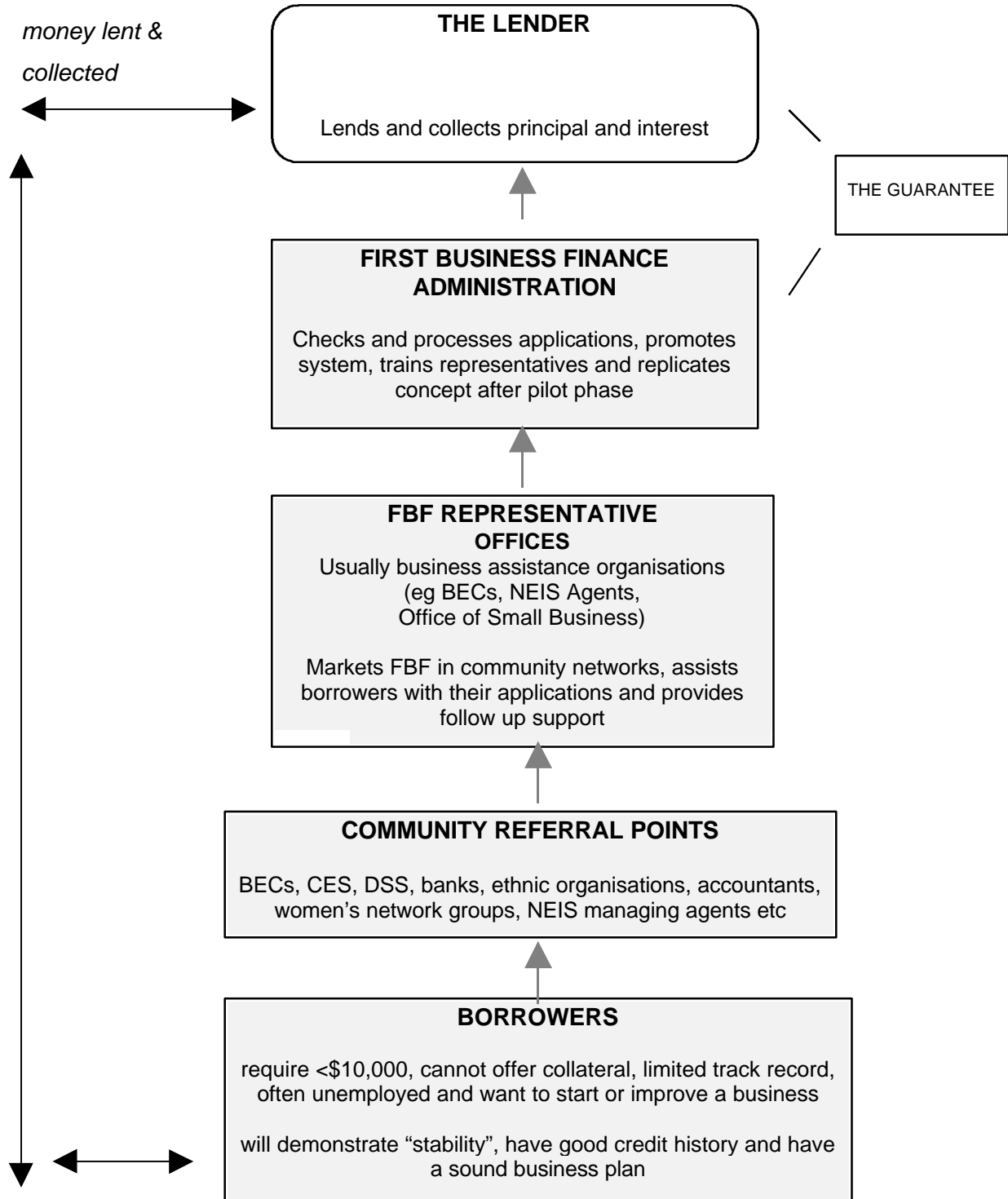
SLEC, with its broad guidelines, allowed us to use our experience of local conditions to create a service which has the potential to make a real difference to the lives of thousands of Australians and, through their efforts and initiative, to enhance the economic capacity of their communities.

SLEC also acted as a lever for other development funds. At the time of writing, \$245,000 has been committed by the NSW Department of Business and Regional Development, and various local councils to assist with the operations of FBF over a three year period.

This report focuses on how the SLEC funds were used to research and develop the new service, and offers a critical view of the development process. It begins by presenting an overview and an initial assessment of the achievements of the organisation to which MELF gave birth, **First Business Finance (FBF)**.

James Evans
August 1995

FIRST BUSINESS FINANCE OVERVIEW



INTRODUCTION

FBF is a facility which introduces to designated financial institutions people who require small sums of money, often unsecured, to start a new business, or improve an existing enterprise.

In the first instance it is operating in Cumberland County. This is bounded by the Hawkesbury River in the north, the Blue Mountains to the west, and Wollongong to the south.

By 30 June 1995 FBF had been operating for nine months. In this period the volume loans disbursed have exceeded expectations by 90%. Forty five credit decisions have been made and the portfolio has a value of \$244,000. The average size of loans is \$8,133, and thirty loans have been approved and drawn down.

Our research indicates that there has never been an initiative in Australia which has lent to this market in a large enough volume to be properly assessed. FBF will need to be commercially viable to generate the necessary infrastructure for sustained growth.

One goal is therefore to achieve volume by delivering to financial institutions borrowers who are "credit-ready". These borrowers are primarily sourced through community business assistance organisations.

In this sense FBF is breaking new ground and has a great deal of support from all levels of government. It aims to demonstrate that an imaginative partnership between a financial institution, the community and government will produce benefits to all parties.

Credit providers will reach a profitable market which until now has been too expensive to service on a commercial basis.

Community organisations will gain profile and prestige from providing a much needed service which will directly result in new business starts and new jobs.

Government will be seen to be involved in a program producing significant financial savings with minimum taxpayers' outlay. FBF's mission complements the Federal and NSW State government's agenda for both regionalisation, and small business development.

COMPANY STRUCTURE & FUNDING

FBF is a subsidiary company of the non-profit Eastern Suburbs and the Botany Business Enterprise Centres. Its board contains a number of external directors who have extensive experience in the credit industry.

FBF is sponsored by all levels of government:

Research and development	Commonwealth Government.
Operational grant	NSW Dept. of Business and Regional Development
Guarantee Account	Local Councils & Commonwealth Government

FBF facilitates loans on a commercial basis. No government money is lent at any stage.

WHO PROVIDES THE FINANCE?

Finance is arranged through an independent financial institution. Credit Unions, in particular, fit FBF's philosophy of a community based, "bottom up" system.

FBF is not the credit provider nor is it an agent or broker for the lending institution.

The role of FBF is as a facilitator, providing specialist assistance and support services to the distribution network and counselling to those wishing to obtain finance to start or improve a small business.

THE GUARANTEE ACCOUNT

Part of FBF's agreement with a designated financial institution is to cover extraordinary losses via a guarantee account. This is approximately 1% of the portfolio's value at any point in time.

This is not a widely publicised part of the service because FBF believes it is important that the client understands that this is a commercial arrangement and not a government "program".

PROFILE OF AN ELIGIBLE BORROWER

("personal lending for business purposes")

A borrower meets a number of criteria. He or she is:

- an individual
- seeking to start a business, or improve an existing venture

- looking for small sums of finance (typically \$5,000-\$10,000)
- unable to access this finance from alternative sources (which should be explored first - particularly equity finance)
- able to demonstrate work history and stability of residence
- able to produce a business plan with financials

From the credit provider's point of view FBF is a cost effective way of entering this market. Borrowers are delivered with business plans and applications for credit completed. Prior to the application being received there are therefore no marketing or administration costs for the lending institution.

THE REFERRAL NETWORK

The success of First Business Finance depends on identifying eligible borrowers through community networks. We also believe that by sourcing clients in this manner, they will feel a greater obligation to repay.

The ideal point of referral is therefore a community-based organisation which already counsels and trains people in business plan development.

THE REFERRAL POINT

A referral point takes on the following roles:

- gives information to enquirers about First Business Finance
- filters out ineligible enquirers
- assists the enquirer with the development of a basic business plan to the point where the business advisor/facilitator is satisfied the client or his or her business has the capacity to service the loan being sought
- refers the enquirer to FBF, or the local Representative Office (see next page), to complete the application for credit

There are two primary referral organisations:

BUSINESS ENTERPRISE CENTRES (BECs): community based non profit organisations which assist new business starters with business counselling, training and other support services. There are approximately 150 BECs in Australia assisting approximately 40,000 businesses annually.

NEW ENTERPRISE INCENTIVE SCHEME AGENTS (NEIS): These agents, which include BECs, offer training and support to unemployed people starting businesses. In the first year of business the successful graduates receive mentoring, further training and a Federal Government subsidy (equivalent to benefits). All applicants are assessed by a panel of local experts. It is a competitive program and in our experience only one in ten applicants survive this selection process to the training stage.

REPRESENTATIVE OFFICES

These are referral points appointed by First Business Finance to assist borrowers with their applications for credit and, in selected cases, to deal directly with the credit manager of the financial institution.

The Representative Office and FBF have a contractual relationship

THE RELATIONSHIP OF FBF TO THE CREDIT PROVIDER

It has already been stated that FBF has no influence over the credit decision. However it is essential to the success of the initiative that the credit provider has a real interest in lending to FBF's market on a commercial basis. If standard commercial credit criteria are applied it should be recognised that the portfolio will not be profitable.

Prior to signing contracts an agreement is reached about the target market, *and the credit approval process.*

The contract also covers the following:

- ⇒ FBF's objectives
- ⇒ termination of agreement
- ⇒ the limits to FBF's authority
- ⇒ the application and establishment fees
- ⇒ record keeping
- ⇒ collection process
- ⇒ portfolio review dates
- ⇒ definitions of "estimated net loss" and "net loss"
- ⇒ process for establishing losses
- ⇒ the terms covering FBF's guarantee

INITIAL EVALUATION OF FIRST BUSINESS FINANCE

For the purposes of evaluation First Business Finance operations are deemed to have started in October when the process of establishing an office in ESBE was begun, and First Business Finance Pty Limited began trading in its own right. This evaluation occurred on 30th June 1995

PROJECT AIMS - EVALUATION BENCHMARKS

- 1) to facilitate debt finance to the micro business market
- 2) to create a replicable model
- 3) to prove the market is viable
- 4) for FBF to reach financial viability

ACTUAL ACHIEVEMENTS AGAINST PROJECT AIMS

- 1) the volume of loans is exceeding forecast by 90%
- 2) the process is working, however not entirely according to model; credit approval is slower than anticipated
- 3) the market is viable to the extent that the distribution system is clearly working and the volumes are satisfactory, however it is too soon to tell if the net loss rate will be higher or lower than expected
- 4) the current process is too cumbersome to achieve the throughput that will allow financial viability which depends upon:
 - a) a faster process
 - b) sharing in the interest spread on the loan
 - c) appointment and training of a network of Representative Offices

SHORT TERM STRATEGIES

- 1) new capital to increase resourcing to the point where Representative Offices can be established and trained
- 2) new credit provider who will adhere to the agreed process, or provide leverage to use against existing credit provider
- 3) long term financial viability: establish new sources of funding, either through additional grants/sponsorship or through becoming a credit provider

PERFORMANCE AGAINST FORECASTS

The business plan set a target of 31 loans to be disbursed in the first year of operation. It estimated the portfolio value to be \$248,000, with an average loan size of \$8,000.

The following table shows actual performance against forecast, both in the number of loans disbursed, and their value in the first nine months of operations:

It should be recalled that during the market research phase, analysis of approximately 20 Australian loan schemes in this market indicated that none of them had disbursed more than 5 loans in a year. From this benchmark, our projections of 31 loans in the first year of operation appeared ambitious.

LOANS APPROVED OR DRAWN OCTOBER 1994- JUNE 1995

LOANS DISBURSED	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	TOTAL
Forecast number	0	0	0	1	1	3	3	3	5	16
Actual number	0	0	1	1	8	2	4	10	4	30
Forecast value (\$)	0	0	0	8000	8000	24000	24000	24000	40000	\$128000
Actual value (\$)	0	0	5000	10000	63000	20000	29000	86000	31000	\$244000

AVERAGE LOAN SIZE - (FORECAST) \$8,000

AVERAGE LOANS SIZE - (ACTUAL) \$8,133

While the pilot project is ahead of budget, it should be noted that it is too early to establish a trend, and therefore to confidently predict the outcome for the twelve month period and beyond.

PROFILE OF APPLICANTS WHO GOT LOANS

BY SEX

Male:	19	63%
Female:	8	27%
Partnerships	<u>3</u>	<u>10%</u>
	30	100%

SECURITY OFFERED

None of loans disbursed have had "bricks and mortar" security behind them. However 5 loans (16%) were for vehicles over which Bills of Sale were required by the credit provider.

BY EMPLOYMENT HISTORY AND STATUS OF BUSINESS AT POINT OF APPLICATION

EMPLOYMENT/BUSINESS STATUS	Number	%age
Starting new business and unemployed/NEIS	19	64%
Starting new business and employed	7	23%
Existing business and self employed/company director	4	13%
TOTALS	19	100%

“THE PIPELINE” - ANALYSIS OF CLIENT FLOW

The 30 loans disbursed were the result of 123 referrals. There is a six stage “pipeline” between referral and drawing down the loan:

STEP 1 - PENDING - 123 year to date (45 current at 30 June)

After referral, a client is interviewed over the phone to form an initial assessment of their case for finance. The key criteria is that they require less than \$10,000 and have a business plan. The information is recorded on an enquiry sheet.

STEP 2 - TERMINATION BY ENQUIRER OR FBF (30 year to date)

This usually occurs prior to an face-to-face interview taking place.

STEP 3 - LODGED (2 current)

Where a face-to-face interview has taken place, application for credit has been completed and then lodged with the credit provider

STEP 4 - DECLINED BY CREDIT PROVIDER (15 year to date)

When credit provider declines the application for credit

STEP 5 - APPROVED (none current)

When credit provider approves application

STEP 6 - DRAWN (30 year to date)

When applicant signs contract with credit provider and draws down loan

SUCCESS RATE BY SEX

	MALE	FEMALE	TOTAL
TOTAL NUMBER OF ENQUIRIES	83	38	121
LOANS APPROVED/DRAWN	22	8	30
SUCCESS RATE	27%	21%	25%
TOTAL CREDIT DECISIONS	33	12	45

LOANS APPROVED	22	8	30
SUCCESS RATE	66%	66%	66%

Thus far in the pilot the conversion rate from enquiry to approval appears to be the same amongst men and women.

CONVERSION RATE AFTER LODGEMENT WITH CREDIT PROVIDER

TOTAL NUMBER OF LOAN APPLICATIONS LODGED: 47

Awaiting decision 2

Declined 15

Approved/Drawn down..... 30

**APPROVAL RATE AS
A PROPORTION OF TOTAL CREDIT DECISIONS..... 64%**

TERMINATION CHARACTERISTICS

After the initial enquiry ("pending" applicant) there are three ways in which a client is terminated:

1. the client declines to proceed
2. FBF closes the client file, often because no further contact is made when the client has been directed to prepare a business plan
3. the credit provider refuses the application for credit

The following table charts reasons for termination by dividing the above categories into Self/FBF termination, CP (credit provider) termination

REASONS FOR TERMINATION	Self/FBF	CP
Business or person's viability questioned	1	8
Financed elsewhere	6	
Outside target market	3	
Poor credit rating	1	5
Poor stability		2
No or poor business plan	1	
Other reasons (client loses contact etc)	18	
TOTALS	30	15

PORTFOLIO PERFORMANCE

It is too early to assess the performance of the portfolio. Our target is to grow to a portfolio of approximately \$1M, or a hundred loans issued, prior to making this assessment.

TURNAROUND TIME FOR CREDIT DECISION

Initial discussions with the credit provider indicated that a credit decision would take 24 hours. In practice this has taken much longer:

Month lodged	Average Days	Lodgements*
Dec	1	1
Jan	12.6	4
February	8.2	12
March	9	3
April	8.6	6
May	7.4	10
June	4.4	7

* *excludes 2 applications which were resubmitted. Inclusion would distort results.*

FBF VIABILITY

It is already clear that developing the referral and representative network will require substantial resources. In the medium term this role requires:

- establishing further sources of finance
- establishing the representative network
- training the network
- marketing the facility
- receiving and presenting cases for finance
- monitoring all aspects of the system for evaluation
- company administration and management

At present the company is being operated by the equivalent of one full time person. In order to achieve the above objectives it is clear that in the medium term two people will be required full-time.

At this stage, therefore, it is clear that FBF will require:

- ⇒ medium to long term subsidy
- ⇒ further subsidy in the short to medium term

CONCLUSIONS

It is too early to form conclusions about the long term effectiveness of the system. However the following points can reasonably be drawn from this evaluation:

1. the network is delivering credit ready applicants despite limited marketing. This volume will increase as Representative Offices are appointed and trained
2. applications lodged with the credit provider, *and approvals*, are ahead of forecasts
3. the high proportion of terminations as a result of the credit provider questioning the business or operator's viability needs to be monitored as the project progresses; this is one factor which is slowing the credit decision
4. portfolio performance will take at least 18 months to assess. Determining market viability is therefore a medium to long term prospect
5. it is clear that First Business Finance itself will continue to need grant or sponsorship subsidy in the medium to long term.

PROJECT CHRONOLOGY

BACKGROUND - AN EXISTING INTEREST

- 1990 UK study trip by ESBECE Director researches alternative forms of finance via BECs, amongst other subjects
- 1992 ESBECE undertakes development work on an investment networking project similar to the Local Investment Networking Company (UK) and Business Angels (US). Not pursued because no funds available for development work, and concerns over prospectus provisions of Corporations Law
- The needs of micro businesses for small sums of unsecured finance is confirmed by ESBECE's first program run under the New Enterprise Incentive Scheme.

SLEC - STIMULATES DEVELOPMENT PROCESS

- May 1993 ESBECE's executive officer participates in discussions with NSW SLEC consultants about strategies for approaching Councils, and the type of economic development projects which may result from a proactive use of funds by NSW councils.
- June 1993 ESBECE itself looks at ideas which may fit into the SLEC guidelines. Small working group formed which includes Waverley Council's Migrant/Employment Development Officer. Two options, based on perceived local needs and opportunities are canvassed:
- an export incentive program to Eastern Block countries
 - a loan fund
- 25th June 1993 A draft outline of options, including a local Micro Enterprise Loan Fund is prepared by ESBECE's director and presented to the group (see appendix A). After further research, permission is sought and gained from ESBECE's Chairman to commit resources to develop a SLEC proposal for "MELF".

DEVELOPING THE PROPOSAL - USE OF LOCAL NETWORKS

July 1993

Proposal is presented to ESBE member, Allan Morton of Finance Efficiency Consultants, who is an adviser to major banks on their lending systems. He is positive about the model, and makes the following observations:

- he believes it will be of interest to commercial institutions if presented in the right manner
- assessment of applicants could be carried out on a credit points system similar to unsecured personal lending (ref: AVCO) because of the small amounts involved
- contrary to popular opinion, and if organised properly, lending small amounts unsecured is a good risk
- volume is essential in order to get a statistical population base on which to judge performance
- leverage from the guarantee account of up to 1:100 should be possible

He also agrees to join a working party in an Honorary capacity

August 1993:

Draft submission to SLEC written by ESBE's Director after consultation with SLEC consultants David Ephraemson, Paul Fitzgerald and Uri Windt

It is thought that a broader population area would enhance the project. ESBE's Director phones Botany BEC's Executive Officer to see if his organisation would be interested in a joint venture.

Committee is expanded to include the Executive Officer of Botany BEC (Peter Morgan), and two further ESBE members; Phillip Abadee (then Chairman of Randwick City's Finance Committee and director of a finance company) and Rob Anderson (partner, Lane and Lane, a legal firm)

17 August 1993:

First formal Project Advisory Committee (PAC) meeting

Discusses legal issues, in particular whether Prospectus Provisions of Corporation's Law will apply to Council's Guarantee, and whether the new Local Government Act will restrict Councils' involvement (Section 356, it is thought, will allow this).

Committee informed that there had been expressions of interest from four local councils to contribute to a guarantee account

	Submission by Finance Efficiency Consultants (Allan Morton) to develop MELF tabled and approved by committee
	Draft of SLEC submission tabled
26th August 1993:	PAC meeting; Lawyer (Rob Anderson, Lane and Lane) attends
	SLEC submission finalised and agreed
	PAC informed that Waverley Council has committed \$10,000 to guarantee account subject to other Councils' involvement and SLEC funds being obtained
	PAC approves approaches to credit providers
3rd September 1993	Meetings held with Commonwealth Development Bank and Sydney Credit Union. Both agree in principle to become involved as credit providers
	Application to SLEC jointly submitted by Eastern Suburbs and Botany Business Enterprise Centres
8th September 1993	PAC meeting
	Informed that SLEC application had been signed by ES & B BECs and lodged with LGSA
	Reports submitted on discussions with financial institutions, councils (guarantee funds), and the Maranatha Trust (lends to people in developing countries)
23rd September	After discussions with SLEC advisers, submission amended to increase funding sought from \$40,000 to \$60,000 to include cost of evaluation report and \$10,000 towards guarantee account
11th October	Submission to State Government's "Jobtarget" program submitted for \$50,000 contribution to guarantee account (later rejected on grounds that the amount is for capital and therefore outside guidelines). Officers suggest an approach to DIRETFE, Self Employment Development Program, for operational funds.
8th November 1993	Commonwealth Development Bank agrees to put proposal to its Board
6th December 1993	Written notification of MELF's approval for SLEC funding received
8th December 1993	Contract signed with Finance Efficiency Consultants (see Appendix C)

9th December 1993	PAC expanded to include representatives of Botany BEC's Board, and Botany Council
13 December 1993	Commonwealth Development Bank declines further involvement after new General Manager appointed. Request for a meeting to discuss this turned down
17th December 1993	PAC defines its role vis a vis sponsoring bodies (see Section 4) Further credit providers identified and committee members delegated to approach (NAB, State Bank of NSW, GIO, IMB)
20th December 1993	Sydney Credit Union visited and agrees to develop proposal
1 January 1994	"My Business" publishes profile of MELF
6 January 1994	NSW Department of Business and Regional Development agree in principle to fund the revenue costs of MELF
21 January 1994	Sydney Credit Union agrees in writing to become credit provider
3rd March 1994	First instalment of SLEC grant received Negotiations with Sydney Credit Union agree the credit approval process
March 1994	Lawyers investigate implications of Credit Acts Formal business plan submitted to NSW Department of Business and Regional Development for operational funds
13th May 1994	The name "First Business Finance" reserved with the Australian Securities Commission
17th May 1994	ESBEC signs contract with the NSW Department of Business and Regional Development for operational funds to be granted over three years
2nd June 1994	First Business Finance Pty Limited incorporated
July 1994	Project Advisory Committee wound up, its function taken on by the first Board of First Business Finance Pty Limited
December 1994	FBF executive officer takes up position and first loan approved

METHODOLOGY

INTRODUCTION

From the outset the sponsor's approach to MELF, and to the SLEC project, was empirical. The chronology outlined in the previous section reflects this. The idea was to establish a new service which would test our assumptions, rather than to research the subject with the goal of producing a report of primary and secondary data which would make recommendations for action.

This document is therefore written as an "action report", a documentary of the development of First Business Finance, and the initial experiences of the new service.

Like many local development initiatives, the genesis of the project was the result of a local need being experienced and defined at first hand. The process of prescribing a response to this need relied heavily on local consultations.

However the "Chronology" does not describe adequately the methods used to shape what eventually became First Business Finance.

"LAUNCHING PAD" - THE EXPERIENCE OF A BUSINESS ENTERPRISE CENTRE

To understand the way the project developed, it is helpful to know the organisation primarily responsible for the initiative.

A BEC is a community-based business assistance organisation. Its role is to foster new jobs through the enterprise of local people. In practice this is manifested in a number of services, at the core of which is a publicly funded business counselling service.

The organisation is run and controlled by local people through an annually elected Board of Directors taken from the organisation's membership.

Beyond this, the services which are developed depend primarily on three factors:

1. the nature of the area being served, its demographics, labour market, industry base, economy and politics
2. the skills and experience of its voluntary Board of Directors
3. the experience and skills of the organisation's executive officer

In 1995 there are 49 BECs in NSW, and approximately 150 Australia-wide.

In ESBECC's case, within two months of opening its door in February 1990, the Board of Directors had asked the Executive Officer for a list of "projects" to consider for development. Of the seventeen presented at the next Board meeting, one was a "local loan fund". At the time the Board considered ESBECC to be too young an organisation to embark on such an ambitious project. It chose instead to develop its local membership base. It focussed on becoming a "co-operative" of small businesses in which the experience of existing business operators (members) could be recycled to the benefit of new starters and businesses looking to develop (clients).

This strategy - phase 2 of ESBECC's development after the establishment of its counselling service - resulted in monthly business workshops for what, by 1993, was over 100 ESBECC members.

Phase 3 of ESBECC's development was to establish a training section which would focus on competency based "enterprise" training, primarily for new starters in business. It was during the process of establishing this unit that the organisation became an agent for the New Enterprise Incentive Scheme, a training and support program for unemployed people who wish to start their own ventures.

ESBECC's method of operation was and is to use the experience of its one-to-one contact with clients in its existing services to identify market needs which can in turn generate new services. The Board had determined that new projects should meet a number of criteria. They should:

- fall within ESBECC's core mission of practical assistance to micro-business which results in local job creation or retention
- add value to ESBECC's existing services (and not take resources away from them)
- attract enough resources to become a stand-alone project which can also contribute to covering central overheads

So, by June 1993, ESBECC had already conducted some desk research into alternative forms of finance to meet the needs of a specific market which had been identified through the advisory service; new starters and existing businesses which:

- required "micro" loans for start up capital or expansion
- were unable to access finance from traditional sources, such as family equity or bank loans

ESBECC had already conducted preliminary research into an "equity option" via local investment networking, connecting people with business ideas with high net worth individuals, as well as looking at other models of debt finance.

However none of the initiatives researched met all of ESBECC's criteria for new project development; it was particularly difficult to find the funds required to research and develop such a service.

SLEC, therefore, was the right type of funding, in the right place, at the right time. The resources provided by SLEC allowed us the time to answer some essential questions.

WHY WON'T BANKS LEND TO THIS MARKET?

Methodology: interviews with members of the credit industry and ESBECC's own experience.

The reasons why banks were not lending to our clients were already well documented prior to SLEC, and were confirmed in our conversations¹ with members of the credit industry:

Sue Dahn in her 1992 Churchill Fellowship Report "The Missing Link - A Directory of Financing Initiatives for Small Business-Generated Community Economic Development" stated the following:

"The "capital gap" for small business can occur because proposals:

- *are generally for small amounts of capital which tend to entail transaction costs similar to large amounts but for which financial institutions may not be able to derive comparable returns;*
- *tend to require time consuming investigation by staff, further reducing returns;*
- *are often non-standardised and not easily traded in secondary markets making them an illiquid investment for financial institutions and therefore likely to be perceived as higher risk;*
- *tend to be for medium to long term periods yet the increasingly short term deposit structure of financial institutions makes long term lending a riskier proposition;*
- *often do not have the collateral traditionally required by financial institutions and are therefore likely to be perceived as high risk;*
- *may not have proprietors with a track record and established credit rating preferred by financial institutions which will tend to increase their perceived risk,*
- *that start-ups have a high reported failure rate which increases their perceived risk*

¹ In addition to Allan Morton, discussions were also held with the credit managers of local banks

- *may not have large monetary equity to invest which may be perceived by financial institutions as lack of commitment and high risk;*
- *may have proprietors who are low-income individuals or who come from disadvantaged groups. Financial institutions may be unaccustomed to dealing with these people professionally and may perceive them as higher risk propositions;*
- *may have proprietors who do not have personal contacts in the financial sector who could 'open doors' and act as referees; and*
- *may be undertaken for lifestyle reasons as well as monetary ones this may make them more difficult to understand for financial institutions and lead to a perception of greater risk."*

It was interesting to note that all credit managers we talked to not only agreed with the above assessment, but also acknowledged that there was a *viable* demand for small sums of commercial debt finance in the market place. Many stated that they had encouraged clients to ask for personal loans, rather than to disclose the commercial purpose behind the application. All acknowledged that a proportion of their bank's personal lending portfolio was in fact for business purposes.

One interviewee told us the following story:

In the 1970's a large American bank conducted a study in one of its New York branches. It instructed its credit staff to lend to customers if they requested less than \$10,000 and they already held an account at that branch. Beyond satisfying this criteria, no questions were to be asked or checks (such as credit reference, purpose of loan) conducted. The loans disbursed in this manner were to continue until an assessable portfolio of over one million dollars had been developed. The performance of the portfolio was then to be monitored.

The result of this study was that there was a slightly higher net loss rate than would normally be expected in a personal loan portfolio. However when the minimal marketing and administration costs were taken into account, the portfolio performed as well as any other in the banks product list.

The key lessons for MELF from these discussions were:

- that the moment individuals ask for small loans to start businesses, they are treated by banks as if they are unemployed; this is stated in the sense that, at the time of our study, cashflow lending, as opposed to loans that are secured against assets, was not entertained by banks where a client was intending to start a business.

- that what MELF was proposing was personal lending for business purposes. Primarily FBF would be seeking individuals who would repay small sums of debt finance; a credit scoring system would therefore have to be part of the system
- the marketing and administration costs would have to be minimised if a credit provider was going to subscribe to the system. The key to attracting a financial institution to our target market was therefore the system by which clients would be delivered to them.
- that the network through which they were introduced would have to provide quality applicants with business plans which had already been assessed. Furthermore, this assessment process would have to be acceptable in the eyes of the credit provider

Apart from the observation that *all* applicants for small sums of commercial debt finance are treated as if they were unemployed, the above discussions did nothing to dispel the reputation that new business starters had of early failure.

IF NEW BUSINESSES FAIL, WON'T NEW BUSINESS BORROWERS DEFAULT?

Methodology: our own experience, discussions with members of the credit industry, desk research.

The high rate of small business failure, particularly in the early days of development, is something that most people with an interest in small business take for granted. However the experience of ESBEC, particularly through the New Enterprise Incentive Scheme (NEIS) where a longitudinal study of new businesses takes place, appeared to contradict this premise.

By the end of 1994 over 90 new businesses had graduated from ESBEC's NEIS program in two years. At the point of survey there was a survival rate amongst all graduates in excess of 80%². Most that had not continued had found jobs or were in second businesses. In other words, they remained economically active. Only one could be identified as being back on social security benefits.

This led us to investigate some of the research that had been conducted into small business failure.

Anna Borzi, in her study titled "The Gender Finance Gap", draws on international research to question the received wisdom about small business failure. The most telling research we found was conducted by John Watson and Jim Everett of the School of Commerce at the University of Western Australia³. In the study they look

² This national figure, at least 12 months after the NEIS subsidy had finished and 24 months after starting their businesses was a 54% survival rate with a further 9 % being in "other employment"

³ "Defining Small Business Failure"

at the definitions, or “proxies”, of failure in existing studies. These range from “bankruptcy” through “discontinuance of business for any reason” to “failing to make a go of it”. The conclusion is clearly that the failure rate of small business depends on what proxy is used for failure.

Watson/Everett highlighted this message by studying the history of 5,083 small businesses that commenced in the period 1961-1990 in 52 managed shopping centres in Australia. In this period the total business discontinuances were 50%, made up as follows:

<i>Discontinuances by Classification 1961-1990</i>	<i>Number</i>	<i>%age</i>
1. Bankruptcy/loss to creditors	180	4%
2. To prevent further losses	414	8%
3. Did not make a go of it	303	6%
4. Retirement or ill health	127	2%
5. To realise a profit	915	18%
6. Other (non-failed)	282	6%
7. Unknown	330	6%
Total Discontinuances	2,551	50%
Continuing Businesses	2,532	50%
Total Start-ups	5,083	100%

The “discontinuance for any reason” definition of failure would produce a very different interpretation of these figures from a proxy such as “bankruptcy/loss to creditors” which would be more relevant to a financial institution.

During the course of researching MELF we also met the Program Director of the Maranatha Trust. In 1992 this Australian company lent \$US6.6 million in 15 developing countries. The average loan size was \$484 and there was a 92% pay back rate. Their claim was that these activities had freed 177,242 people from chronic poverty and had created or salvaged 44,946 jobs. All loans were made to poor people who, through borrowing, became business owners.

Their system relies on local “partners”. Loan applicants are screened through community groups and local churches to obtain character references. Many borrowers attend seminars (948 seminars were organised for 17,429 participants in 1992) in small business management skills. On-going advice and encouragement is given through site visits by Partner Agency staff.

The Maranatha Trust is one of many models of micro finance working in the developing world. A further study on this type of lending, with a range of OECD country examples is also available in Susanne Dahn’s 1992 Churchill Fellowship Report “The Missing Link - A Directory of Financing Initiatives for Small Business-Generated Community Economic Development”.

The key lessons for MELF from this research were:

- that ESBECE's experience of micro-business *success* rates was not atypical
- that the quality of training and support offered by the network used by MELF to source clients would be critical to the scheme's success
- that discontinuance of business will not necessarily lead defaulters, or net losses to the credit provider

“EVEN DWARFS START SMALL” - WHERE DO OUR CLIENTS FIT IN THE OVERALL PICTURE?

Methodology: collection of primary and secondary data, interviews with the BEC and NEIS managing agents network

One concern which travelled with us during the research was that the new service would be based on our experience in the eastern suburbs of Sydney, a relatively affluent area, although containing identified pockets of economic and social disadvantage.

Many of ESBECE's clients were starting businesses as lifestyle decisions, or because they saw no other satisfactory work opportunities in the labour force. To what extent would a service based on this client profile be replicable elsewhere?

The experience of running a Business Enterprise Centre very soon challenges any prejudices the executive officer has about “the entrepreneur” and small business development. The presumption is often that a BEC's role is to attract tomorrow's publicly listed companies. It is true that most BEC managers can point to clients who arrived as acorns and are now well on the way to becoming oak trees. However the majority of a BEC's clients fit the image conjured by the German film title “Even Dwarfs Start Small”. They are dreamers who arrive with ideas that are often not much more than hobbies. The first thing that an experienced counsellor seeks to investigate is not the idea and its viability, but what is motivating the client. What does the client want out of the business, and is there a determination to achieve his or her objective?

The dangers of making an assessment based on an economic rationalist's view of viability, the profit and loss statement and assessment of return on investment, without taking into account personal motivation and external influences are manifest in the following case study from ESBECE.

A man, 38 years old, wants to start a pet minding service. His idea is to visit the pet-owners' houses while they are away on holiday or business to look after the pet. He has no background in business, in fact has been a public servant for twenty years. “I have a child”, he says, “and I only want to work an average of

three days a week.” He is thinking of charging the equivalent of \$25 per hour, he says.

The counsellor has two options. The first is a contribution method of pricing which will very soon reveal that the business is not financially viable. The second is to ask more questions about the client’s domestic situation.

In this case, he and his wife were practising Christians, he said. Both had held down full time jobs and were paying for day care as well as a part-time nanny. They hardly saw each other, or their child. He had decided to give up his job and become a part-time “house-husband”.

After taking into account marginal tax rates, reduced childcare costs (and some childcare assistance) they had calculated that the owner’s drawings from a business would only have to be \$16,000 per annum for the family income to remain the same as when they both worked.

This case study is indicative of a number of trends evident in the work of the Eastern Suburbs BEC since 1990:

- the high proportion of clients whose motivation for starting a business was as much lifestyle as monetary wealth
- a number of clients who held down part-time jobs which neither gave them the quality of work or the income they needed to survive. A business was seen as a means of supplementing another job
- the unemployed spouses of full time workers whose income barely met the weekly needs of the family; a business was again seen as means of generating a second income

Some desk research was conducted to try to assess whether the above experience was representative of broader trends, particularly what we termed “supplementary enterprise” where the business income was secondary,

The July 1993 issue of the OECD’s “Employment Outlook” gave 1992 figures for involuntary part-time workers in Australia, defined as “part time due to inability to find a full time job”.

Number	% of total part-time	Total %	Men	Women
513,000	27.4	100	38.2%	61.7%

The Australian Bureau of Statistics reported an increase of underemployment of 57% between 1988 and 1991, with 85% of the underemployed being part-time workers wanting more work. The majority of the under-employed being women.

The notion that such fall-out from the re-structuring of the Australian labour force is driving the growth in self employment was supported in a Department of Social Security submission to the Committee of Employment Opportunities in Canberra:

“Evidence suggests that workforce restructuring and the onset of the recession have ... contributed to moderate growth in various forms of self employment. As the economy recovers, people may increasingly seek employment alternatives such as self employment - particularly (as seems likely) if the job losses experienced in large businesses during the recession are not reversed.”

This submission also went on to confirm the presence of the full-time “working poor” with dependent families in Australia:

“In August 1992, almost 300,000 married full-time employees (10%) earned less than \$340 per week ...” This weekly income is, in the words of the report, “similar to the cut out point for married allowance rates.” In other words many of these full time workers with families would be better off on unemployment benefits, rather than working.

Of most importance, however, was an assessment of our colleagues in the Business Enterprise Centre network. To assess their perception of demand for this service a survey⁴ was sent to eight Sydney BECs. In it they were asked to state whether they believed there was a “viable demand” for the type of finance MELF was proposing.

The key findings of this survey were:

- that seventy five per cent of their clients who sought finance, required loans of \$10,000 or less
- this equated to 25 people per centre per year (200 in all)
- if those who had been unemployed for six months or more were excluded, the total number of annual referrals would from eight centres would be 54
- all BECs believed that the extra cost of borrowing would not be a deterrent to their clients

From the above research we concluded:

- that there is no conclusive evidence of underemployment and “working poverty” causing a growth in self employment, however there was enough circumstantial evidence to conclude that those who were entering self employment as means of supplementing an existing income is not atypical of ESBECC’s clients
- the demand for micro loans was confirmed by other Business Enterprise Centres, with the primary demand being for sums of \$10,000 or less.

⁴ see [appendix D](#)”

DIFFERENT SHOES IN OTHER PEOPLE'S FOOTSTEPS?

Methodology: telephone survey, desk research

The model of finance proposed by MELF was not unique. There have been many other innovative forms of finance which have, for instance, utilised guarantee arrangements both here and overseas.

However the details of First Business Finance are designed to overcome a number of weaknesses evident in previous initiatives, the principal difficulty appearing to be achieving a statistically assessable volume of loans⁵. To quote from an earlier paper produced by MELF:

"Our research⁶ has considered a number of models of finance, international as well as domestic. Relevant initiatives close to home fall into four broad categories:

- **Government lending:** where a government lends, or occasionally grants money to new start businesses, usually when principal/s are unemployed. This is often limited to the New Enterprise Incentive Scheme (Self Employment Venture Scheme in Queensland, which lends, interest free, from its consolidated revenue)

Key weaknesses:

- often there is lack of "real world" environment for the starter
- usually excludes existing businesses
- no leverage with the result that there is greater expense to tax payer when losses occur
- vulnerability of mechanism to changes in policy

- **The preferential arrangement:** where a government body or non-government organisation makes special representations to a financial institution on behalf of the target market. Current examples include NEIS graduates with the Commonwealth Development Bank⁷ in NSW, and a similar arrangement for Enterprise Agency clients in Western Australia (State Bank)

Key weaknesses:

⁵ Approximately 20 local loans funds were contacted during research, none of which had disbursed more than 5 loans in the previous year.

⁶ A large number of interviews have taken place, both with managers of loan funds, government officers and specialists in the field. Sue Dahn's 1992 international study entitled "the Missing Link" has been extremely useful, as has the input of consultants Paul Fitzgerald, David Ephraemson and Uri Windt. Government officials have also provided detailed information from Victoria, West Australia, NSW and Queensland.

⁷ No longer operating in 1995

- relies on credit managers who understand the market and acknowledge value added in BEC/NEIS process
- often misses target market; volume of unsecured loans tends to be low
- **The guarantee or "comfort zone":** where a guarantee is offered, usually by a government body, to cover financial institution's losses. Leverage tends to range from 1 guarantee dollar to \$1 lent, to \$1:\$20 (Capital Access Program, Michigan, USA).

Key weaknesses:

- there is an over-reliance on government if leverage too low
- reduced incentive for banks to act prudently, especially on collections with resulting distorted loss rate
- **The community fund:** where a community organisation raises capital to lend on to local businesses - there are various mechanisms to achieve this, but most appear to suffer low volumes:

Key weakness:

- extremely low volume, because
 - * in order to avoid the expense of compliance with the prospectus provisions of the Corporation's Law the fund often narrows its target market to the extent that minimal loans are made
 - * usually started by community organisations with limited existing resources, and few extra are recruited because the funds do not generate adequate revenue.
 - * most resources are committed to seeking capital with the result that marketing is poor (often because of the perception that the organisation will be flooded with enquiries which it doesn't have the capacity to deal with).

Occasionally these methods can be mixed; for instance a community loan fund may act as guarantor for a client's loan from a commercial institution. The style of community loan fund is also very varied, the target market can be defined by geography, sex, disadvantage, and operational methods may also vary a great deal.

The clear message we have received from this research is that in Australia there is no commercially viable fund lending to the target market in a large enough volume to be properly assessed.

FBF aims to achieve both volume and commercial viability.

At the very least FBF will act as a model that can properly evaluate the notion that a market niche exists for these types of arrangements by adequately marketing, and planning to achieve realistic volumes.”

BUT IS DEBT FINANCE APPROPRIATE TO THIS MARKET?

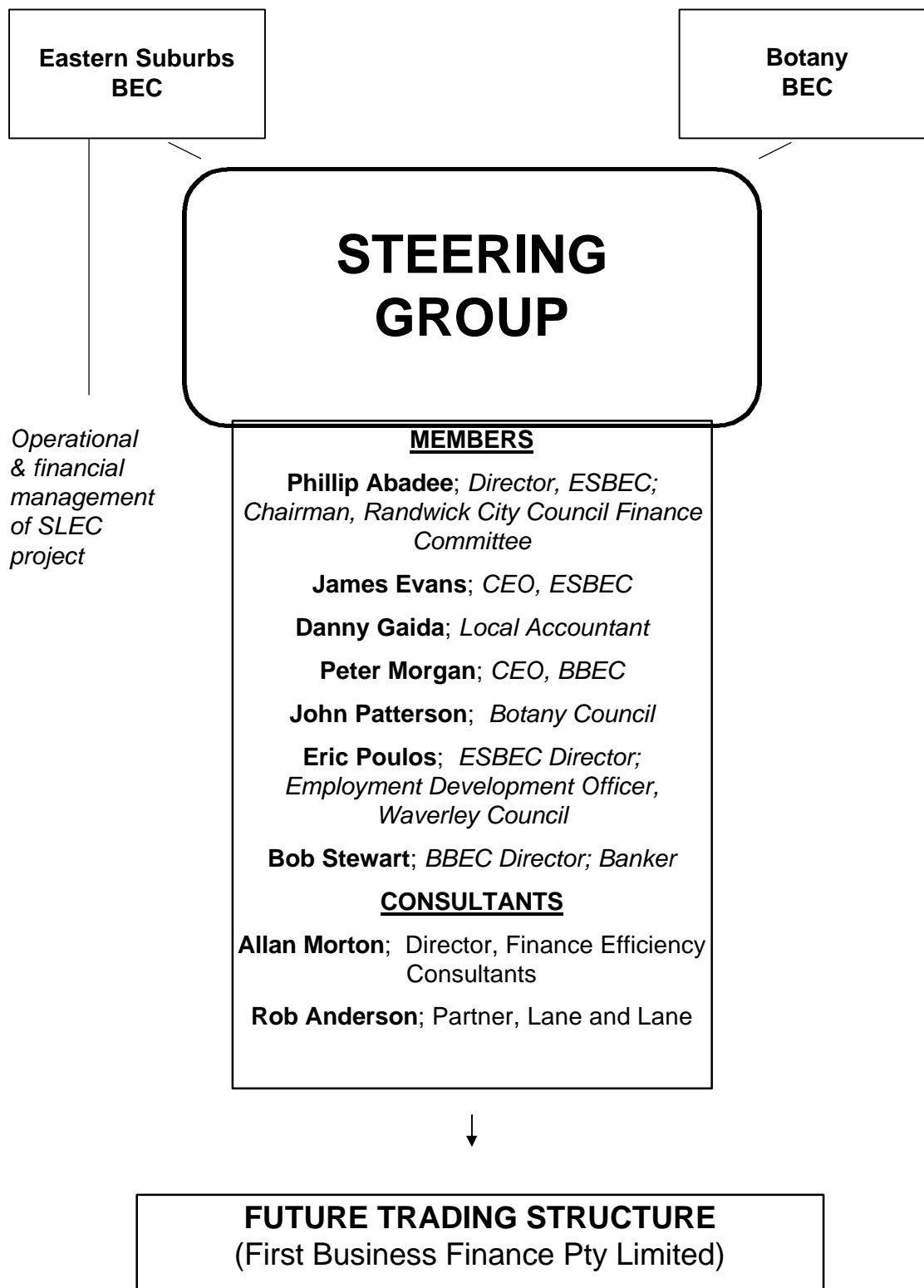
Most advisers would agree that debt is not the ideal way to start a new business venture. In most cases equity is preferable because it lowers a business' overheads and (can) increase the skills available to the business.

In view of this and after discussions with its consultant, the MELF project committee decided to take the following steps:

- to negotiate a product which as much as possible was “debtquity”; variable interest, longer term (5 years) with no penalty for early repayment
- to suggest to the network of referral points that their clients should have considered sources of equity finance prior to making any application for a MELF loan

PROJECT MANAGEMENT PROCESSES

The MELF project was managed by a steering group made up as follows:



The steering committee had delegated power to develop MELF from the boards of both sponsoring organisations. The extent of this delegation was determined by corporations law (no contracts could be entered into by the committee) and the discretion of the executive officers and board representatives from both sponsors which sat on the steering group.

Operational management of the SLEC project and its funds were the responsibility of ESBECC.

The employment of the consultants was determined by the committee. The principal consultant, Allan Morton, had been acting in an honorary capacity prior to SLEC funds being received. On 17th August he submitted a proposal to the committee to assist with the development of MELF. This was approved, subject to SLEC funding being approved. Once funding was approved a contract was signed between FEC and ESBECC, after consultations with Botany BEC.

The life of the Steering Committee was agreed to be until a separate legal entity was formed to manage the project. This occurred in June 1994.

First Business Finance Pty Limited has two shareholders, the Eastern Suburbs Business Enterprise Centre Limited (70 shares) and the Botany Enterprise Development Agency Limited (30 shares). Its first Directors were the Chairmen and executive officers of both sponsor organisations.

The Board of ESBECC determined that as soon as practicable at least two external Directors should be appointed who had a knowledge of the credit industry. Subsequently Allan Morton and Anna Borzi have been appointed to the Board. Ms Borzi was Chief Manager, Securitisation, Commonwealth Bank of Australia and Head of Business at the Export Finance Insurance Corporation before starting her own consultancy practice.

First Business Finance signed a contract with its first credit provider, the Sydney Credit Union, on 19th August 1994.

In December 1994 it recruited a Loans and Marketing Manager to work day-to-day of FBF's activities. This position and the majority of FBF's operating costs are funded by the grant from the NSW Department of Business and Regional Development for two pilot projects, the first in metropolitan Sydney, the second in a non-metropolitan area.

From July 1995 FBF has employed a Managing Director for three days per week; it is envisaged that this will become a full-time position if:

1. the pilot projects prove a success
2. further funds are raised to subsidise the core operations (see next Section for further commentary on this point)

SUMMARY OF CONTRACTS MADE		
PARTIES TO CONTRACT	DATE	COMMENTARY
Local Government & Shires Assoc & ESBEC/Botany EDA	24/2/94	Outlines term/conditions to research and develop "The Micro Enterprise Loan Fund" project. Funds committed (\$60,000): <ul style="list-style-type: none"> • \$50,000 consultant fees • \$10,000 contribution to guarantee account Funds to be paid in three instalments
NSW Dept. Business & Regional Development & ESBEC	17/5/94	Agrees to provide start up and development finance for "MELF. Agrees amount to be supplied and performance benchmarks for its disbursement. Schedule for disbursement <ul style="list-style-type: none"> • 1994/95 - \$130,000 • 1995/96 - \$ 50,000 • 1996/97 - \$ 30,000
Sydney Credit Union & First Business Finance Pty Limited	19/8/94	Main terms: <ul style="list-style-type: none"> • FBF is authorised to assist applicants with submissions to SCU for funds • SCU agrees to adhere to procedures as defined in the appendix to contract • FBF undertakes not to act as intermediary, or advocate for clients to SCU • SCU agrees to collect \$250 on behalf of FBF to cover the latter's operational costs • FBF agrees to deposit \$10,000 in FBF account at SCU (to cover 1% of portfolio at end of May each year) • states that SCU is wholly responsible for lending and collecting principal and interest • agrees the conditions under which funds from the guarantee account will be paid to SCU
ESBEC & Botany EDA & FBF Pty Limited	1/12/94	Gives a brief history of the MELF project and agrees terms of disbursement from ESBEC to FBF: <ul style="list-style-type: none"> • ESBEC receives all funds in connection to the project • interest from funds held to be applied to FBF

A CRITICAL SELF-EVALUATION

DELAYS

The Chronology will show that the MELF project had early successes in gaining local council and credit provider support. However it took longer than expected to move from agreement in principle to a working pilot.

This was due to three reasons:

- the delay between gaining SLEC approval in early September 1993, and receiving funding on 3rd March 1994. In order that the delay did not affect the commercial relationships that had been formed, ESBEAC had to commit expenditure from its reserves prior to March.
- the unexpected withdrawal of the Commonwealth Development Bank in December 1993 also affected the project's schedule. At this point we had advanced negotiations to the point where we expected contracts to be drawn up within a week. Their change of attitude coincided with the appointment of a new Managing Director, and a new policy which raised their minimal loan to \$50,000. Negotiations had to be started from scratch with the Sydney Credit Union in the New Year.
- ESBEAC under-estimated the impact of its role as project manager on its core operations. This became particularly evident in the middle of 1994 when ESBEAC's expansion meant that development of the newly incorporated First Business Finance (FBF) had to be put on hold.
- The recruitment of a staff member to FBF proved problematic, requiring two sets of advertisements. The position was eventually filled by word of mouth in December 1994.

INSURANCES

Our initial approach to the insurance market for Professional Indemnity and Directors and Officers Insurance was unsuccessful. Our broker indicated this was because our service was new and, being small scale with no precedents, it was "too hard".

We therefore sought and gained an interview with the chief underwriters for both of these insurances at a large Sydney based insurance company. At this meeting we presented a business plan written to our broker's specifications. The result was an agreement after which both insurances were written, but with coverage capped at \$500,000 until FBF had gained track record.

LEGAL ISSUES

Legal advice indicated that FBF would not require a finance broker's license under current credit legislation. At the time of writing it is not clear what effect, if any, the impending Commonwealth credit law will have on the company.

OPERATING COSTS

The initial vision was that FBF would be run by one full-time worker on an annual salary of approximately \$30,000. A peppercorn rent of \$2,000 was also budgeted on the assumption that this person would work from within ESBE's current offices.

One of the early lessons of the pilot was that the demand for loans, and the process of assisting applicants with their submissions was time consuming. The liaison with the financial institution's credit manager also required more time than we originally anticipated. These tasks also need skills that (we found) are not easily recruited in the market place.

In addition to this there were, and are, onerous management and development tasks to be undertaken. These include the development of publicity materials, promotion within the referral network, procedures and training manuals for Representative Offices, and negotiations with further credit providers, guarantors and networks outside Sydney.

In the near future, therefore, FBF will be seeking funds for:

- two full-time workers
- commercial rent for new premises (the expansion of ESBE has required that it move premises)
- a car, which will be essential if FBF is to expand its operations outside Sydney
- miscellaneous overhead items, such as insurances, computer networks etc which are currently subsidised by ESBE

In view of this, it is clear that the goal of FBF itself reaching commercial viability will be medium to long term, and will rely on significantly increased volumes.

FACILITATORS CAN'T BE LENDERS

The advantage of dealing with Credit Unions is that they are philosophically aligned to our mission. However, one of the inherent restrictions of FBF's relationship with the credit provider is that we have no input to the credit decision. It is not possible to bind a financial institution to lending to certain types of people because, put bluntly, it is their money, their liability and therefore their decision.

This is not to say that FBF doesn't have input into lending policy. Weekly communication takes place between FBF and the credit provider, with two formal

face-to-face meetings per month. The spirit of the relationship is both co-operative and constructive.

The early signs are that as the volume increases, and defaulters start to appear, the criteria for approval will be tightened. The first symptom of this has been a detailed investigation of the business plan and, occasionally, interviews organised between the client and the institution's credit manager. The dangers of this are:

- a higher proportion of rejections, and therefore a slower build up to FBF's first goal, a statistically valid volume of loans
- extra cost to the credit provider caused by in-depth assessments resulting in lower margins
- credit refusals leading to disillusionment of the referral network
- lower income to FBF and therefore longer term reliance on subsidy

At present our strategy is to maintain close communication with the credit provider; working meetings every week, and a policy meeting every two months at which the shift in criteria is discussed. These meetings also serve to monitor the change in attitude, something that will be of value when the first full year's operation is evaluated.

THE MILLION DOLLAR QUESTION

At the time of writing the portfolio stands at over \$300,000, the first representative offices are soon to be appointed, and a second financial institution has committed \$500,000 (in the first instance) to a second pilot project outside Sydney. The first steps of FBF are promising.

However the principal question, whether the FBF system is selecting clients who will repay their loans, has yet to be answered. Our first goal therefore, and the one on which the company will stay focussed, is to achieve a statistically assessable volume in excess of \$1 million.

James Evans
First Business Finance

August 1995

FINAL SLEC REPORT TO LGSA - NSW

SCHEDULE OF APPENDICES

APPENDIX A

The first in-house SLEC paper

1.0 STRENGTHENING LOCAL ECONOMIC CAPACITY (SLEC)

The 1992/93 Federal budget earmarked \$5M for spending nationwide on a SLEC project.

The purpose of the program is "to generate more efficient local structures and processes for facilitating local and regional economic and employment growth".

1.1 Strategic Plan for NSW

A strategic plan is being drafted for NSW which will identify "priority subject areas" in which pilot ventures can be funded. The funding is available to ventures operating within local councils, or in partnership with them.

During the planning process I was consulted as someone with experience of local government/economic development issues.

The strategic plan for NSW has still not been published, however I have been talking to Waverley Council (Eric Poulos) about projects which may benefit the Eastern Suburbs, in anticipation of publication.

What follows is two project ideas for possible submission by Waverley, Randwick and/or Woollahra Councils to the SLEC Program.

2.0 LOCAL LOAN FUND

2.1 Introduction

Many viable new businesses do not start, and existing businesses do not survive, for want of small loans (\$5-10,000). The result is lost economic (and employment) capacity in the Eastern Suburbs.

2.2 The Equity Gap

There are many reasons why this gap exists; principal amongst these are:

- i. potential borrowers do not have collateral
- ii. it is not profitable for commercial institutions to lend such small amounts
- iii. small business is a high risk investment

2.3 The Proposal

The principal feature of this proposal is that SLEC funds are used as a lever to encourage a local financial institution to lend to local business/self employed persons:

- + A credit union establishes the loan fund in partnership with ESBECC and the local business community

- + The Eastern Suburbs LGAs act as part guarantor to loans issued. They will establish a Trust fund in which the SLEC money will be deposited (NB no ratepayers funds will be employed)
- + Eligible borrowers will submit proposals to a panel which includes CU, ESBEC, and local business (& Council?) representatives
- + Successful applicants receive professional assistance and support over the loan period from ESBEC
- + The Credit Union administers the fund and lends at commercial rates

2.4 Eligible Borrower - A definition

Borrowers can be new start businesses or existing businesses and must meet the following criteria:

- + be residents of the Eastern Suburbs and/or
- + operating, or intending to operate a business in the Eastern Suburbs
- + the loan sought must be below \$10,000
- + their request for a loan must have been rejected by a bank
- + they must have undergone, or be willing to undergo a recognised course in small business management skills
- + their submission must be in the form of a business plan which has been screened by ESBECC (which has the sole authority to submit to the lending panel)
- + in addition to the Credit Union's establishment fee, the borrower must remit the (annual) sum of \$250 to ESBECC as a contribution to the organisation's costs.

3.0 EXPORT INITIATIVE

3.1 Introduction

The export potential of small to medium sized enterprises (SMES) has recently been highlighted by McKinsey's report for the Australian Manufacturing Council, "Emerging Exporters".

Current Federal Government policy is to take Australian companies to export markets through such programs as "Export Access".

Little effort is being made to:

- i. promote the lessons of McKinsey's report to SMEs a local level
- ii. stimulate the idea of export "clusters" of small business which, alone, would not have the capacity to export
- iii. to facilitate buying by Australian residents/visitors who have networks in importing countries

3.2 ESBECC's Observations

Through consultations with Danny Gaida, and his contacts in Eastern Europe, the idea of proactively encouraging Sydney SMEs to export to that region has been discussed. The Eastern Suburbs was seen to be an ideal location for such a pilot initiative because of its high proportion of residents with contacts in that region (Hungary, Poland, Russia).

Coincidentally, ESBECC has had approximately ten enquiries in the past three months from people seeking buy Australian goods and export them, principally to Asia. All have identified difficulty in sourcing the goods, and dealing with Australian suppliers. All had contacted Austrade but appear to have been told that Australian companies rarely deal with individuals/strangers, and prefer to work through agents with track records.

3.3 The Proposal

At this stage there is no agreed proposal. However it is believed that were a proposal devised it would qualify as a nationwide initiative under SLEC, even if it were piloted in one area.

The overall goal of a proposal would be to increase export volume through local initiatives.

One internal objective for ESBECC may be to become a "centre of excellence" for: any Syc

On the face of it there appear to be two paths to this:

- i. submit an "active" research project to the SLEC program to investigate the above markets and organise a series of seminars which would aim both to identify export markets, and potential export "clusters" of SMES.
- ii. do some desk research upfront, and seek funding for an export development officer to work in ESBECC for one year. A work program would have to be devised which included much of i. above, as well as a list of services, marketing strategy, benefits to consumers and expected (economic) outcomes.

Needs more work.

4.0 AGREED ACTION

Eric Poulos to consult David Ephraemson (drafting NSW Strategic Plan) to see if above ideas are likely to meet SLEC criteria.

Eric Poulos to talk to Waverley Council's General Manager about WMC's relationship to Sydney credit union

James Evans to draft proposal for Eric Poulos, Danny Gaida and ESBECC Chairman Anthony Etzine for comment.

Ref- slechte

25/6/93