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Banks do not deliver to entrepreneurs!

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Door: Christian ter Maat

Superflash bank Milan, Italy

Dear Entrepreneurs, Amsterdam, November 11, 2012

I have been meeting with many of your colleagues over the past few months; ranging from fast food chains to audio manufactures to retailers and I hear one shared comment; BANKS DO NOT DELIVER! The loan desk is closed or permanently out to lunch!

I rob banks for a living, what do you do?
[quote; John Dillinger]

What is the role of a bank?
Commercial banks facilitate global business by being the intermediaries that move money from the capital markets to businesses and institutions. Banks get their money through business checking or deposit accounts, service fees and by issuing certificates. The European Central Bank manages the euro, safeguards price stability in the EU and is also controlling the money supply (banks loaning to each other).
Commercial banks hardly lend out, at this moment, or are involved in Roll Overs; (a loan that a borrower may renew upon maturity) or refinancing (to repay a loan by

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taking out another loan). Hence there is no investment/growth capital available to entrepreneurs; hence no work for bankers and less turnover/profits for banks. A downward spiral for all!

What is the business model of a bank?
Most commercial banks make money in several ways. First, the majority of revenue comes from accepting deposits and then lending that money, with higher interest, out to individuals and businesses in the form of bank loans. Banks also make money by charging fees, commissions and penalties and by delivering consultancy services (e.g. M&A or IPO).

Cooperative bank; makes a difference?
The essence of cooperative banking is that members, who include both savers and borrowers, use the cooperative to recycle money from those who have it to those who need it, without anybody outside taking a profit and with interest rates set so that the system works in everyone's interest. The cooperative banking sector is extraordinarily large; the International Raiffeisen Union estimates that 900.000 cooperatives with around 500 million members in over 100 countries are working according to the cooperative banking principles worked out in Germany by Friedrich Raiffeisen. In Europe alone, there are 4.200 local cooperative banks, around 60.000 branches and a market share of 20%. The banks serve 45 million members and 159 million customers. Some of the largest banks in the world are cooperatives: RABO bank, for instance, has nearly 2 million Dutch citizens in membership and many more clients, is the largest agricultural bank in the world and is rated the world's 10th safest bank.
Difference; not really. Cooperative banks, behave as commercial banks, cooperative heritage is more a marketing instrument, than a banking policy. Banks have an obligation to assess risks of companies and to base their lending decision and conditions on these perceived risks. During a crisis, the principles do not change, only the markets in terms of companies turnover and profitability.
'Only when the tide goes out do you discover who's been swimming naked." [quote; Warren Buffet]

Not lending, so what?
For banks, lending is a major source of revenues and profits. Secondary, if banks work with the money, it gives better returns to the lenders and, in the larger scheme of business, lowers default risk for the bank itself. For companies to grow, to make investments to merger/acquire, they need banks loans. Lending is basically the license to operate efficiently for companies, banks and the market as whole. According to Warren Buffet; "Price is what you pay; value is what you get". Keen lending to smart entrepreneurs; creates value!

What are the alternatives?
Large companies can issue **bonds or increase the equity capital** by selling more shares.

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Companies can team up in a **keiretsu** (系列; a set of companies with interlocking business relationships and shareholdings. It is a type of informal business group. The keiretsu maintained dominance over the Japanese economy for the greater half of the 20th century. The member companies own small portions of the shares in each other's companies, centered on a core bank; this system helps insulate each company from stock market fluctuations and takeover attempts and enable innovative projects/investments.

The **WIR bank,** formerly the Swiss Economic Circle (GER: Wirtschaftsring-Genossenschaft), is an independent complementary currency system in Switzerland that serves small and medium-sized businesses and retail customers. It exists only as a bookkeeping system to facilitate transactions. WIR was founded in 1934 by businessmen Werner Zimmermann and Paul Enz as a result of currency shortages and global financial instability. WIR is both an abbreviation of Wirtschaftsring and the word for "we" in German, reminding participants that the economic circle is also a community. According to the cooperative's statutes, "Its purpose is to encourage participating members to put their buying power at each other's disposal and keep it circulating within their ranks, thereby providing members with additional sales volume. Although WIR started with only 16 members, today it has grown to include 62.000; total assets are approximately 3.0 billion CHF.

Founders; were a small group of business owners in Switzerland convened to talk about their troubles. It didn’t take long before they realized that one of them needed a credit line from the bank to pay a supplier. That supplier in turn needed the same kind of credit line for similar purposes. They decided to work together to create a mutual credit system, where instead of borrowing money from banks they issued credits and debits to each other at the moment of an exchange to keep production going and, at the end, it would all balance out.

Today; in many countries in Europe; entrepreneurs are talking about setting up credit funds among themselves. To set-up a fund and raise capital, will take some time and efforts. Eventually banks will wake up or finish their everlasting lunch and compete with these funds.

And investors?

Yes; they have been around for ages. Generally, they tend to invest in return for equity/control. Equity sales are advantageous because they don't require any repayment and most businesses don't turn a profit for a significant time period. If you are an established business and have ongoing financing needs, then loans may make a lot more sense. Finally, the cost of a loan, interest, are deductible costs for tax purposes (Netherlands), providing that a company makes profit.

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Characteristics of a loan; repayment schedule, interest, interests tax deductibility, no control.
Characteristics of equity sales; shared control (& meetings), dividends, increased network, advice, dilution/additional investments.
Cost of capital of a loan (incl. tax deductibility), will always be cheaper than expected long-term returns by investors.

Equity investors at the seed, early and later stage of firm growth

Informal investors		Formal investors
Founders, friends and family	**Angel investors** (typical investment size: 25-500K USD)	**Venture capital funds** (typical investment size: 3-5M USD)
Seed stage investments	***Early stage investments***	***Later stage investments***

Financing gap

source; OECD
Angel investors are increasingly forming groups and syndicates to pool funds to fill this financing gap. Venture capitalist are at a relative early stage of a company's development. At maturity, Private Equity (PE) houses are the main source of acquiring 50+% equity, regularly with a minimum enterprise value of 12 million USD. PE firms use a combination of equity and debt; leveraged buy-out.

We should never forget why we enjoy some of today's luxuries - most of them are because someone else had a long-term vision and was prepared to invest for the future.
[quote; Warren Buffet]

Crowd funding?
Crowd funding; the practice of funding a project or venture by raising many small amounts of money from a large number of people, typically via Internet. Equity Based Crowd funding is a mechanism that enables broad groups of investors to fund startup companies and small businesses in return for equity. Investors give money to a business and receive ownership of a small piece of that business (equity and /or debt). If the business succeeds, then its value goes up – and so does the value of that share of that business.
The crowd funding approach allows good ideas, which do not fit the pattern required by conventional financiers. to break through and attract cash through the wisdom of the crowd. If it does achieve "traction" in this way, not only can the enterprise secure (seed) funding to begin its project, but it may also secure evidence of backing from potential customers (pre-sales) and benefit from word of mouth. A disadvantage for business is the requirement to disclose the idea for which funding is sought in public. This exposes the promoter of the idea to the risk of the idea being copied and developed ahead of them by better-financed competitors. Another significant disadvantage to crowd funding is the possibility of getting trapped in various securities laws, since soliciting investments from the general public is most often illegal unless the opportunity has been filed with an appropriate securities regulatory authority.

Trends?
Early stage loans will, due to the banks current attitude, grow the market share of angel investor networks, venture capitalists and crowd funding platforms. Banks had the monopoly on vast sums of money and risk assessment professionals. The best in class M&A, investment, due diligence and other financial professionals are working for Venture Capitalists and Private Equity houses today. Will banks be able to turn around the downward spiral.

I wish you appropriate and timely funding for your endeavors,

Christian

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