Funding the Future

The government is expecting one in three companies in t…

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The National Audit Office has issued a stark report this morning. It refers to risks within the loan schemes made available to businesses with government backing to help them survive the coronavirus crisis.

In the key paragraph in the report the NAO says:

As a result of credit and fraud risks, the Department and the Bank's preliminary central estimate is that 35% to 60% of borrowers may default on the loans but the estimate is highly uncertain. Government's default estimates at Scheme launch ranged between 30% and 75%. The latest estimates, including those including those by the Bank and the Office for Budget Responsibility, have widened to between 15% and 80% depending on the UK's economic performance. According to the Bank, credit and fraud risks are interrelated and therefore it did not assess them separately. The Department's 2019-20 annual report and accounts highlights likely total credit and fraud losses of between 35% and 60%, based on historic losses observed in prior programmes which most closely resemble the Scheme. Assuming the Scheme lends £43 billion, this would imply a potential cost to government of £15 billion to £26 billion. However, actual losses may differ from those forecast and indications of the extent of credit losses and fraudulent applications will not become apparent until borrowers are due to start repaying their loans. Loan repayments begin from 4 May 2021 as government is paying interest on all loans for the first 12 months.

Overall,the report suggests fraudulent claims may represent between 0.5% and 5% of all balances. That means losses of up to £2 billion may arise for this reason. That will, almost entirely, be a cost attributable to the lax regulation of U.K. company law, to which I have referred on this blog countless times. Surely it will now be appreciated that having a proper regulatory environment in place that really permits abuse to be traced makes sense? I would hope so.

But more importantly, that still means bad debts of between 10% and 75% are expected on this scheme, with a mid range estimate of around 50% seemingly being likely.

It’s my suggestion that most of the defaults will be amongst limited companies, simply because it is much harder for a sole trader or partnership to default when they have personal liability for the sum owing. That means that, give or take (and the data is not finalised as yet) it is possible that up to 500,000 companies may fail according to those who have offered them loans. To put this in context, there are around 1.5 million trading companies in the U.K. based on tax return data. And the government is expecting roughly a third of these to fail.

That’s the real message of this report, but I am not seeing that drawn out in the commentary in the press.

And, if one in three businesses fail so too does the employment associated with it.

Of course, some of these failed businesses will re-emerge, Phoenix like. I am well aware of that. But there will be disruption, chaos and employment loss along the way.

Not all will be immediate, I accept. But, this report does, whatever its supposed theme, and however it is reported today, really set out the scale of risk that our economy faces, including on the employment front. The companies to whom these loans were made might be small, but they employ millions of people. And those jobs are at real risk, which this report acknowledges. And still the government is not recognising the scale of the crisis that we face as the economy heads for its real downturn, which has yet to happen. I seriously wonder how they have got things so wrong.