UNITED KINGDOM

Recovery position

Phil Ward analyses the UK business climate after the biggest credit meltdown in history

It's been a turbulent year in the City of London

Marcus Brooke, Sonifex

Dave Marshall, Sound Technology

Britain is a multicultural society. British-ness, regardless of the hopes and dreams of certain political and sentimental interests, is a very difficult thing to pin down. From Romans to Vikings, Normans to Huguenots, Jews to Jamaicans, the gene pool is very deep. If you want some kind of DNA-proven aboriginality, take your torch and sandwiches and head for the caves of Cornwall and Wales. You've an equal chance of finding Camelot.

It follows that the UK is a multicultural market. Once it was the Empire that channelled the world's resources – and people – to and from Britain's coasts with such magnetic attraction; now there's a pale but potent successor in the EU. Hardly as romantic, but probably less dangerous. So it should come as no surprise that UK businesses are so entwined with European roots, and so amenable to globalisation.

It's therefore difficult to isolate the UK economy as such, or to trust statistics that appear to provide a simple percentage index of UK performance. Each individual company has its claims and counter-claims, but it's not usually until an announcement of receivership or administration that a true picture emerges. The continued existence of names is a tacit signal of survival, while actions of aggressive expansion and acquisition are assumed to indicate prosperity – even though they could be founded on misplaced confidence. All of the above have been witnessed on the UK stage during the past 18 months, a period already notorious for the biggest banking crisis in history and a recession most characterised by the squeeze at every level on credit.

Financial times

Much of the economic comment in general circulation is an attempt at self-fulfilling prophecy. If it's negative, it's likely to be a de-stabilising strategy; if it's positive, it's almost certainly a gambit to inject confidence into an uncertain marketplace. "In reality," comments Paul Robson, founder of specialist entertainment technology asset finance broker Medialease, "you have a finely tuned balancing act between customers reluctant to spend, because they're not sure if we've turned the corner, and banks who are being very cautious about who they lend to and under what terms."

Recent government announcements about renewed banking generosity are almost certainly disingenuous morale boosters, because few operators in pro audio, for example, can anecdotally point to any evidence that funding now is any easier than it was a year ago. That was the point at which Lehman Brothers collapsed and the chain reaction of failing financial institutions began, causing a recession unknown since the 1930s or even, some would say, the turn of the 19th century.

"There is no such thing as an open cheque book any more," observes Robson. "Banks are looking at their 'exposure' to each client as never before, and there's a new set of rules that we all have to live by. We've had a wholesale change in the way we do business over the past 18 months. I would say that 50% of the attractive, client-friendly deals have disappeared forever – half the over-generous lenders have closed down. At the other end of the market, where everything has to be heavily guaranteed and interest rates are high, there is money around but few people want it. The deals are tough and unattractive."

The self-imposed regulations that financial institutions are now imposing centre on what they call return on equitable capital: instead of borrowing from other institutions on the money markets to raise capital to lend out, banks are capping their exposure at no more than 20 times their own market value. Previously, the bonus culture had encouraged brokers to lend out far more money than their own company was worth, to push up turnover. When market confidence failed and share prices fell, these institutions found that their own equity did not match their exposure and subsequently failed. A return to more responsible lending, within equitable boundaries, was essential.

This has led to perfectly good businesses being turned away at the lender's door because they don't match the newly strict criteria, at a time when cash is scarce anyway. After a period of careless risk assessment, altruistic players with valid propositions are paying the penalty. This was more or less what befell Lincolnshire-based loudspeaker manufacturer Logic System when one of its biggest customers, troubled retailer Sound Control, went into liquidation leaving a huge unpaid invoice. Despite a full order book, founder Chris Scott was obliged to sell the company's core assets to new investors. Although these

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are sympathetic to Scott's aims, being associated among other interests with digital jukebox maker NSM Music, Scott feels that the government's decision to bail out so many banks is at odds with the general idea of supporting UK manufacturing.

"It was a great excuse to get out of supporting the industry," he says. "I remember seeing the bank manager and saying, through the government, the 17 people at Logic System have lent you 'x' thousand pounds to survive. If you lend us that money back, we'll be in clover. But the answer was no..."

Distributed weight

Others were luckier. When John Midgley created Polar Audio as a UK distributor by purchasing its assets from German roots as beyerdynamic's UK subsidiary, he drew upon a then healthy cashflow. He remains on the board of the German mic manufacturer, but feels his newly independent status in the UK relieves pressure from outside forces. "Shortly after the buyout we went into recession," he muses, "but

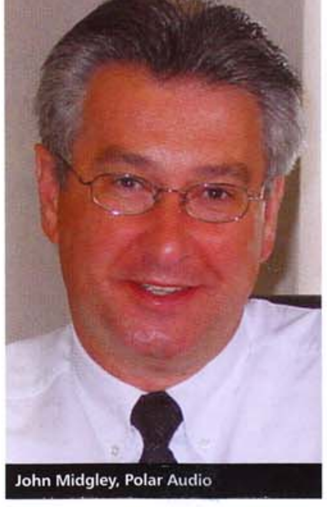

Bob Thomas, Cadac


Paul Robson, Medialease

the reasons for doing it didn't change. Beyer UK was always a broad distributor, and I wanted to do things our way. We don't want to do everything for the sake of what we show the banks at the end of each quarter. Those companies with heavy borrowing have suffered the most, so I'm glad we're still a relatively small operation without those obligations."

Without the export dimension, distributors have to rely on diversification and their ability to spot upward trends and exploit them. HHB has even diversified into manufacturing, expertly navigating the recession with renewed international interests that keep the wolves on UK Chancellor Alistair Darling's forehead from the door. At Sound Technology, MD Dave Marshall has spotted one growth curve and sees "very small" green shoots in the level of project enquiries. "We noticed an upturn in interest as far back as PLASA," he says. "The projects are both big and small, some are soon and others two years away, but they are being followed up. It wasn't just idle talk. I'm comparing that to PLASA 2008, when there was no such interest and 2009 proved to be bereft of major work.

"The other key market that is enjoying growth is cinema, so much so that it almost caught JBL unawares – this last autumn especially. It's incredible; there's a lot of new-generation projector technology coming out, and it seems operators are taking the opportunity to upgrade the audio at the same time. Plus, I guess, people like to escape to the movies when times are hard!"


John Midgley, Polar Audio

Factory records

The manufacturing sector can look overseas, whatever the weather at home. In the live sector audiences are up worldwide, although Ohm's Clive Kinton acknowledges that "rental companies are not replacing their equipment as quickly as they used to". As well as leaning on the export cushion, Ohm has increased its trade promotion in a bid to stand out from the crowd. "We've increased the budget for trade press and exhibitions, but there's no doubt that the late-night entertainment sector is dragging its refurbishing heels. Fortunately we're finding that education budgets are secure, so that market's been very buoyant."

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Kinton also feels that the recession has encouraged customers to spend more wisely. "When things were booming, we'd find our high-end systems being shunned in favour of cheap Chinese alternatives that people were happy to replace after 12 months. In the past year that's changed: they're choosing systems that will last because they need a long-term return on investment. It has educated the market to our advantage, in a way."

Radio and TV broadcasting specialist Sonifex has also increased exports, but MD Marcus Brooke adds a slowdown in Ofcom community broadcasting licences to the usual UK recession woes – including the liquidation of equipment show SBES. "I think in this sector we're scarcely half-way through this," he comments, "and we can wait until 2011 to see real improvement. We're re-appraising sensibly and looking at the education market – we'll be at the BETT show in January. Radio into schools is quite a hot topic. We're niche, we're a family business and we're profitable, but if you know any rich investors out there..."

Quite. The exceptions to the rule that funding is no easier are those who have gone abroad to get it. Two very high-profile cases have emerged in the UK recently, for different reasons but with several parallels. Midas/Klark Teknik has finally severed its ties with Bosch and entered into an eye-catching marriage with Behringer, where investment now seems almost limitless. MD David Cooper has no regrets. "In our former regime we were a very low investment priority," he says, "and now we're discussing some very exciting funding ideas. We are global, but the UK is still the second most important market in the world. It may be only a percentage of our total sales, but the UK punches far above its weight in the concert sound arena. We'll continue to give it top priority."

Meanwhile Cadac is now Chinese-owned, with the SoundKing Group having pulled the venerated British brand out of the UK's icy waters just at the right time. "They bought us to invest and bring products to market," says general manager Bob Thomas, "and the modern UK manufacturer lives by exports. It's not just a UK recession, of course, so it's not a get-out clause. We are no longer an isolated island, so you have to find the right partners from a much wider pool."

Gear change

Nobody can tell when recovery is guaranteed. Robson expects another two years for the measures now in place to take effect. "I think it will work," he says, "because we've taken such a sharp knife to the situation. The banking mechanisms now should, over time, identify the weaker companies that will have to make their assets work harder for them – or disappear. 'Gearing' is the term to measure how much you borrow against the value of your assets, and from now on that ratio is going to have to be exactly right."