



Project Manager
Retail banking market investigation
Competition and Markets Authority
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Dear Sir/Madam

FSB response to Competition & Markets Authority Issues Statement on the Retail Banking Market Investigation

The Federation of Small Businesses (FSB) welcomes the opportunity to respond to the above named call for evidence.

The FSB is the UK's leading business organisation. It exists to protect and promote the interests of the self-employed and all those who run their own business. The FSB is non-party political, and with approximately 200,000 members, it is also the largest organisation representing small and medium-sized businesses in the UK.

Small businesses make up 99.8 per cent of all businesses in the UK. They contribute 50 per cent of GDP and employ 60 per cent of the private sector workforce.

The SME banking market is underperforming due to actual and perceived issues of limited availability of finance and lack of transparency around terms and pricing, leading to low levels of uptake of finance by small firms. Further to our submission on the consultation on undertaking a market investigation, the FSB welcomes the decision to investigate the retail banking market and supports the investigation being based on the three theories of harm.

In addition to our previous submissions, we make the following comments against the theories of harm:

1. *Impediments to customers' ability to effectively shop around, choose and switch products or suppliers, resulting in weak incentives for banks to compete for customers on the basis of price, quality and/or innovation.*
 - o The Business Banking Insight (BBI) survey is one of the few means that provide more information to firms to assist their choice of bank. As this is a recently launched initiative, awareness is low as would be expected and therefore its impact on the market limited. Over time, and as awareness of the BBI increases, this should increase. At this stage, and until the BBI is established as a reference point, we remain concerned that information is limited, and further efforts are required to improve comparability of different offers. The FSB supports both increasing information on bank products and in addition, increasing awareness of substitute products such as, invoice finance (factoring and invoice discounting), asset finance (including leasing and hire purchase) and peer-to-peer lending. Substitute products



provide diversity in the market and give SME more ability to find a financial product that more accurately meets the needs of the business. However, as noted, awareness of these options and therefore uptake often remains low within the small business community.

- The FSB agrees that the provision of retail banking services to SMEs, as defined in the terms of reference, should include: general purpose business loans; deposit accounts; and liquidity management services, including business current accounts (BCAs) and overdrafts. However, as set out in the Statement of Issues Hypothesis 1(b) (assess), a key characteristic of the market is that many products and charging structures can be relatively complex. The FSB recommends that hedging products such as embedded swaps or tailored business loans should be included within the scope of the market investigation. The bundled nature of the product and the resulting lack of transparency regarding, for example, break costs, lead to high levels of financial detriment for SME. Our membership has told us they were:
 - sold their loan by 'commercial teams' within banks
 - not told of the break costs by their bank, and were at that point, unaware of the expensive costs
 - not aware they had tailored business loans until they tried to break, exit or move the loan
 - concerned these products could damage both their business and personal credit performance

There is no regulatory oversight on the sale of these products to ensure all customers should be clear on what they are purchasing, so they can make an informed decision.

2. *Concentration giving rise to market power of some banks leading to worse outcomes for customers.*

- There is little to distinguish between the products and services provided by the big 4 banks. Business Banking Insight (BBI) results¹ showed that large banks performed on a very similar basis, with small firm customer satisfaction levels on Business Current Account ranging between 57% and 69%, depending on size of firm, with the overall observation that satisfaction levels tended to rise as firm size increased. The narrow range of scores might suggest that the larger banks offer homogenous products, with little pressure to differentiate themselves and compete for new customers.
- Of the small firms that did apply to banks for finance, 50% failed to get credit.² By increasing the diversity and number of new entrants in financial services, the FSB believes there would be greater product innovation and appetite to lend to small firms that can be a higher risk with lower yields than larger established businesses. SME Finance Monitor data (November 2014) confirms that banks tend to lend more to larger SMEs than smaller new businesses, with 97 per cent of firms with 50-249 employees having a successful application compared with 73 per cent of sole traders.

3. *Barriers to entry and expansion leading to worse outcomes for customers.*

- As well as acting as an impediment to the efficient allocation of capital, the lack of data sharing by banks and CRAs remains a barrier to entry for new entrants to the SME finance market. Moves have been made to address barriers to entry, in particular the Payments Council current consultation with a focus on reforming in the payments system, and the

¹ November 2014

² Q3 2014 survey - Voice of Small Business



FCA lowering the regulatory barrier for new entrants seeking banking licenses – leading to five new banks being authorised and many more applying. The FSB welcomes these initiatives however it is too early to know how the Payment Council or the new banks (that might not provide SME banking) will change the market. .

- In conjunction with the initiatives on credit data sharing that Government is taking forward the FSB supports the development of a central credit register that all prospective lenders could access. The Bank of England have recently consulted on such a proposal, which is in widespread use elsewhere in the EU. The potential benefits of a comprehensive business register would be to give new entrants and established finance providers access to the same data, and thereby supporting a level playing field. This would increase competition on product innovation and targeted customer support, as well as supporting macro-prudential surveillance of the market. Through competition, customers should benefit from choice on product, service, and cost.
- The lack of transparency by finance providers and CRAs often impedes small firms from understanding how their credit score is calculated. Often at the heart of the issue is the impact personal credit ratings can have on a company's ability to raise finance. Small firms and particularly their owners therefore need greater guidance to understand their credit score and to take steps to improve it, and to challenge it where the assessment is inaccurate. For the CRAs themselves, they should look to see how they can work with the banks to improve their use of credit data, ensuring at all times it is timely.

We trust that you find our comments useful and we would be happy to discuss the market investigation with you in more detail.

Yours sincerely

Mike Agate

Chair – Economics Finance Tax Committee