RETAIL BANKING MARKET INVESTIGATION

Summary of roundtable with SMEs on 2 July 2015

Representatives from the following organisations attended the small and medium-sized enterprises (SMEs) roundtable discussion:

Association of Chartered Certified Accountants
British Business Bank
British Chambers of Commerce
Campaign for Community Banking Services
Confederation of British Industry
EEF, the Manufacturers' Association
Federation of Small Businesses
Financial Services Consumer Panel
National Farmers' Union

Customer requirements

1. It was generally agreed that the primary concern for smaller SMEs was access to the range of banking services, especially for sole traders and the self-employed. Because of working patterns, smaller SMEs had limited time available and access to banking facilities must not be time-consuming. Cash-based businesses would also have particular needs for branch access.

2. High quality service was also important, as well as access to a relationship manager, ideally someone who understood the SME's business and had an understanding of the local market.

3. It was noted that SMEs were generally working to low margins, so price was important, but banking choices were not driven by price alone. Price was perhaps more important to start-ups, but as businesses grew they would have more diverse and complicated needs.

4. Diversity of providers, products and services was also important to reflect the different needs of MSEs. The range in size and requirements of SMEs meant that there was not a one-size-fits-all banking approach. Some SMEs would require intensive support, including face-to-face contact; others much less so. Some SMEs were very IT literate, while others may not even have access to the internet.

5. There was currently not enough diversity of products and service offerings on offer to encourage switching – if there were clearer benefits to switching, more SMEs might do so. It was noted that cost pressures may lead to the larger banks wanting to focus on particular segments of SME, for example property lending and withdrawing from other sectors. There was a risk that this may lead to some sectors no longer being served, but there was also the opportunity for challenger banks to step into those sectors, with rural areas particularly affected.

6. In the main, the larger banks did not provide relationship managers for smaller SMEs. There may be a branch, but it was noted that these were transactional centres and did not generally have SME expertise. Relationship managers tended to be based centrally and, while in large conurbations they were perhaps housed in a major branch, frequently they were based in a commercial park instead and had little affinity or understanding of local business needs. This was particularly an issue for rural based SMEs but also for manufacturing SMEs where the banks were providing less and less specialist support. In addition, Fintech SMEs were also finding it very hard to raise funding from traditional banks and technology companies, similarly due to lack of assets to put up as security.

7. It was noted that often, smaller traders ran their businesses on the back of a PCA account and borrowed against their personal assets. This meant that there were a lot of small SMEs that, while potentially benefitting from lower cost PCAs (subject to overdrafts charges), did not have access to business advice from their bank.

8. For farming businesses in particular, where four big banks were thought to manage about 80% of agricultural banking current and personal accounts, there was a perception that banks had little sector expertise. A survey in 2011 indicated that 71% of farmers considered having access to a branch or someone who understood the nature of their business was important. Such one-to-one contact with someone who understood the business was seen as particularly important where access to the internet was an issue, for example in some rural areas.

9. Start-ups in IP-based sectors such as technology were also mentioned as having difficulty in accessing lending; and challenges were noted in respect of fintech start-ups obtaining banking facilities.

10. It was noted that once SMEs had established a relationship with a bank, they would be reluctant to switch, or even consider switching, in part because SMEs feared a change may impact adversely on lending decisions. It was

suggested that banks did not review their lending/finance needs regularly, and often it was something going wrong that prompted a review of banking needs.

11. There were some indications that while lending decisions were provisionally agreed at a branch level, when decisions were referred up the line for a decision on risk, the loan may be rescinded. This created uncertainty.

12. The view was expressed that some of the newer providers were becoming increasingly selective and operated at the top end; they were reluctant to fund start-up businesses but provided a very high quality service at the upper end of the small business market and lower end of the corporate market. This model was not felt to be replicable to address service needs across the market.

13. It was noted that some banks had suggested that the FCA took a risk averse approach to new product innovation, even where the innovation was prompted by customer demand. However, it was noted that this may be an excuse by banks for a lack of innovation.

14. Crowdfunding was seen as more of a niche market and likely to remain as such, but nonetheless had a valuable role to play. For some SMEs, it was an important and helpful alternative source of funding.

Customer satisfaction levels and switching

15. Satisfaction levels often varied by the size of business, with smaller SMEs being less satisfied with their bank. There was perhaps low expectation from SMEs in regards to what banks provided to them, and expectations were getting lower over time. Satisfaction scores needed to be considered against expectations. That was why net recommender scores were important – SMEs may be satisfied, but not to the extent that they would recommend their bank to other SMEs.

16. It was noted that switching tended to be driven by really poor service rather than expectations of higher service; there was a perception that all banks were pretty much the same and provided the same service/products.

17. Many businesses had all their banking products with the same provider, and this inhibited switching because of fears around the impact this may have on their overdraft facilities, loans, credit cards etc. Many SMEs did not have a finance officer, or at least one with a qualification, so a lack of switching could be related to a lack of knowledge as well as a lack of time.

18. Clear, concise information on what a bank had charged an SME, and the use of comparable terminology across banks, would be very useful to inform

decisions about switching. In addition, requiring banks to routinely refer SMEs to alternative providers and products would significantly assist SME engagement and switching.

19. The indicated that the Business Banking Insight website was a work in progress. It was based on service quality and customer experience and covered all the providers of banking services. It surveyed around 15,000 SMEs in the UK. It provided five different ratings and provided a 'star' rating for products provided by banks. SMEs could also comment on their bank. It was noted that it was still being developed as a tool for SMEs and there would be a push to promote it further this year. It was noted, however, that SMEs responded particularly to advice/recommendations from their peer group. The role of intermediaries such as accountants was, however, very variable in advising SMEs on financial products.

20. It was stated that the geographical scope of some smaller SMEs also limited choice – particularly for cash-based businesses. The practical impact of having to deposit cash, perhaps daily, limited banking options in some areas.

21. Concern was expressed that there was a lack of industry interest and action on improving inter-agency bank arrangements, which would enable customers to share the use of branches, potentially opening up the sector to competition. Use of Post Offices for withdrawals, paying-in etc was seen as a useful addition, but most SMEs only wanted to use the Post Office for banking if they were going in for another service.

22. It was noted that one area where banks did compete for BCA accounts was the period of free banking, which varied from 12 months to two years. While there were comparison websites for BCAs, the SMEs claimed that they were not nearly as comprehensive as those for PCAs, and the information tended to be harder to find.

23. Concerns were expressed regarding a lack of awareness and guidance for SMEs in relation to their banking or wider financial needs and options. Information was gained by SMEs from tax advisors, accountants, their PCA bank and quite often from other SMEs – SMEs talked to their peers through business organisations informally and then perhaps to their accountant. Midata tools seemed to be an interesting development, but business needs were somewhat more complex than personal finance.

24. Research suggested that only 5.5% of farmers switched banks last year. Setting up direct debits and standing orders correctly and building a relationship with a new bank were issues that came up when farmers were

thinking about switching. However, it was noted that the survey pre-dated CASS.

25. The issue of seasonality of business, including farming, was also an issue, and having a bank that understood the business, including cashflow and overdrafts, was essential. This was a barrier to switching as SMEs may be concerned about losing this service support. Payroll operating effectively was also an issue that deterred some SMEs from switching.

26. Some banks were not keen on partial switching and wanted SMEs to switch all their products at the same time – and even if not always true, that was the perception of many SMEs. There was a shared view that it needed to be easier to switch individual products.

27. It was suggested that the account opening process could be time-consuming and a deterrent to switching. However, there was also some evidence that while switching was perceived as a huge hassle, in reality when SMEs do switch they find it easier than expected. There was some evidence that SMEs that had switched in the past were more likely to do so again because it had not been as difficult as imagined.

28. SMEs were concerned that if they had been refused a loan by their bank, ‘shopping around’ may impact on their credit rating.

29. It was noted that more needed to be done to reach out to SMEs about the benefits of switching. CASS had helped, but it was seen as not enough.

30. The more banks understood SMEs and their potential, the more the banks would fight to keep the business and gain new business by offering better deals (and similarly the better an SME understood its development potential, the better equipped it would be to negotiate with banks).

31. It was noted that there appeared to be some correlation between SMEs having a good governance model and having good relationships and being satisfied with their bank. It was also the case that some banks had indicated they were more willing to loan, extend overdraft facilities etc to SMEs with good governance procedures.

32. It was noted that in respect of the Devolved Nations, there were also issues of rurality and density of population – and there were costs associated with those issues – as well as access to broadband.

Lending

33. The view was expressed that SMEs very often left seeking finance for working capital and fixed asset purchases until quite late, perhaps only a week or two before it was required, so often their current main bank would be the most practical option.

34. In a survey by the BBB, 60% of SMEs said that they approached their own bank because it was easier because they already had a relationship – some simply trusted the brand. In the same survey, only 5% of respondents said they used their current bank because of the price. The key issue was about easy access.

35. Awareness of other forms of finance options was low, and it was noted that such awareness needed to be raised. An FSB survey last year indicated that 66% of SMEs turned down for a loan were not offered alternative referral options by their bank. It would be helpful if banks started to think about referral at an early stage where a refusal of finance was deemed likely. It was also noted that a referrals platform was in development where SMEs rejected by the ten larger banks would be referred on to alternative providers, and it would be of interest to see what impact this platform has.

36. Loan security requirements were seen as a big issue for start-up SMEs who would be likely to approach their existing PCA provider about business finance. Where personal loan security requirements were high, that might prompt the SME to start looking at other options and seek a provider who would share more of the risk.

37. In the past, the first port of call for advice on finance would be the bank manager. The bank manager would know the family and business. It was noted that they were now in a transition stage between that and digital, and until the digital age is fully upon them, SMEs faced a dilemma of where to go. It was noted that HMRC was doing some interesting work on tax agents, and that might have an impact.

38. It was noted that small firms that acted as lending agents for SMEs were disappearing and larger agents were becoming more prevalent – but one may have to approach the larger agents online as well.

39. It was also said that overdrafts were very important to SMEs, particularly in dealing with the seasonal fluctuations in their finances. There was a tendency for SMEs to use credit cards as easy financing, but this was expensive and rarely the right form of finance. Use of equity finance for SMEs was more

appropriate for many as it came with more advice and support. Mentoring for small businesses was crucial.

40. It was noted that other countries had a much more diverse funding model for SMEs: for instance in the USA, there was a much larger equity culture.

41. It was felt that there was still a legacy from the financial crisis where many SMEs, particularly those engaged in manufacturing, would build up cash reserves rather than seeking bank lending.

42. There was a general view that politicians had a role to play in avoiding the creation of a climate where there was a perception that banks were not lending, when in reality lending conditions had improved – although start-ups were still struggling. Also, the smaller an SME, the less attractive it was in lending terms.

43. Around 40 to 50% of loan applications were still being refused. This was perhaps consistent with 50% of start-ups going bust in the first three years and debt finance not being the best solution in many cases. As to why competition had not done more to fill the gap, it was noted that the financial crisis had meant that the number of independent freelance consultants who helped SMEs find loans had decreased significantly.

44. Some incumbent banks had very old legacy IT systems and that made accessing data about SMEs difficult. IT was noted that challenger banks were in a better position in that respect.

45. Much of the data on SMEs was within government rather than banks. HMRC was doing good things around trade finance and other platforms for tax data. This could enable more data porting by SMEs. The credit sharing data initiatives that incentivise banks to share credit data with other providers would also help.

46. The value of data/information held by credit reference agencies depended on how it is used. Many SMEs were concerned that sharing their data would have a negative impact, and would not want their data held there, so a consent-based model would be important. It was seen as important for there to be a positive story around the use of credit reference agencies, and that would help give SMEs confidence.

47. There were a few building societies that did operate business current accounts, and they usually did it on the back of one of the big banks. It was noted that credit unions could also now lend to business, but very few had the appetite to do so.

48. It was expected that building societies might be more active in SME lending in a few years. However, the cost of SME lending was high as well as having high risk for building societies. Because of the capital requirements, building societies were having to keep much of their funding for mortgages.

49. It would be helpful for the Bank of England or the Prudential Regulation Authority to look again at challenger banks' capital requirements. Attendees considered that the current capital requirements did not incentivise lending in particular by smaller providers.

50. It was also noted that SMEs may be reluctant to use new sources of funding, such as peer-to-peer lending and crowdfunding, because they stick with what they know. For instance, SMEs would often source finance from their car or lorry provider rather from an independent finance source, perceiving such finance as easier and simpler.

51. SMEs would not necessarily initially seek out invoice discounting, but were more likely to be directed to it.

52. It was noted that businesses were now more risk averse following the financial crisis and less likely to seek outside financing, but that may change as the business environment improves.

53. In summary, it was felt that banks needed to improve perceptions about lending and SMEs needed to work harder to understand which types of finance best suit them.

Branches and relationship managers

54. Many new challenger banks did not have a high street presence, but may be based in commercial parks. Approaches to such banks tended to be through personal recommendations. Some of the challengers that had been divested from incumbents had branch networks that were not geographically balanced and may not be on good sites.

55. Many SMEs were less concerned about a branch network, but wanted effective relationship managers who travelled around. They wanted a personal contact. More use of other media such as Skype was also required.

56. There was some feeling that smaller SMEs that did not have relationship managers might be willing to pay a fee to have one, but that was not currently an option.

57. In some instances during the financial crisis, relationship managers had saved SMEs from going under.

58. As branches closed there needed to be a managed transition from all stakeholders to new ways of working, recognising that less cash and fewer cheques would be used in future. But some form of transaction base would be required for some SMEs.

59. Other innovations were needed: the Post Office could not fill all of the gaps. Shared branch use by banks would be important. Smarter ATMs would also help, and in that respect it was felt that the UK currently lagged behind other countries. The market may change with new online entrants such as Atom and potential fintech involvement, but it was too early to predict the impact of this.

60. However, SMEs had found that face-to-face negotiations could lead to better outcomes compared to online or telephone applications, and discretion remained an important factor.

61. There were also sectoral differences that needed to be taken into account. Some businesses, farming for instance, had a much higher use of cash and cheques than across other businesses – IT businesses may virtually not use cash and cheques.

62. There are plans by banks to scan cheques and that may roll out in 2016 but it would not help with cash payments.

63. Some SMEs had said that there were a lot of these electronic platforms, for example currency-trading platforms, that were quite complex. Quite often banks had ring-fenced them only for the use of mid-sized to larger businesses. It was noted that if you were a manufacturer, you were a sophisticated business; even if you were small, you might need sophisticated services. It was about access to some of the more complex platforms.