CMA investigation into SME banking: British Chambers of Commerce response to updated issues statement

About the BCC

The British Chambers of Commerce (BCC) is an influential network of 52 Accredited Chambers across the UK, representing tens of thousands of businesses with millions of employees nationwide. The BCC is a dynamic and independent business network with Accredited Chambers in every nation and region of the UK, and in key markets around the world.

The BCC is an authentic voice for British business and a leading commentator on the UK economy, drawing on a powerful network that represents business interests in Westminster, Brussels, and in every part of the UK.

Accredited Chambers sit at the heart of local business communities, helping thousands of companies - of every size and sector - to grow and thrive. Together with our fast-growing global network, Chambers provide practical advice and support to British companies trading around the world.

Introduction

The BCC welcomes the opportunity to formally respond to Competition and Markets Authority (CMA) updated issues statement on the SME banking investigation. Our members were fully supportive of the decision by the CMA to undertake a full market investigation into SME banking.

As things stand, <u>our members broadly agree with focus of CMA investigation into SME banking.</u> However, it must deliver results and business also want to see a greater focus on reviewing market restrictions for new non-bank SME finance providers, including building societies.

Our members also believe that the Business Banking Insight (BBI) survey can play a vital role in improving competition in SME banking by providing firms across the UK with a clear and credible way to judge how their bank compares to its competitors based on the views of their own peers.

Theory 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.

Feedback from our members confirms that customer engagement among SMEs with their bank remains limited. There is also little shopping around with businesses typically staying with their bank for a prolonged period of time and purchasing most of their financial product and services from the same institution. One of the main reasons for this is they struggle to differentiate between the major banks and so there is often a reluctance to move to a new bank.

This is reflected in the results from the BBI which revealed very similar ratings achieved by the big four banks across a wide range of indicators. For example, for business current accounts, average satisfaction scores from small and mid-sized firms for the four major banks revealed that, on average, around a third of such firms are not satisfied with the level of service that they receive. Fear over losing existing facilities such as overdrafts is another reason for the lack of SME engagement with banks. We believe that the low levels of switching and customer engagement are systematic of a market that is not functioning well.

The process for accessing finance also remains a major issue. Apart from being arduous, time consuming and costly, each time a business goes through the process of applying for a loan they leave a 'footprint' which could affect their credit rating. This also discourages SMEs from shopping around.

Feedback from our membership suggests that a local presence with a defined market area would help to improve user engagement because local people who are geographically closer to their customers are more likely to better understand the needs of customers, rather than those operating in a central function of the bank. However, have a local presence does not necessarily mean having a branch network or regional banks as this could be achieved by using an existing local network.

Our members also believe also that BBI through showcasing the views and experiences of SMEs themselves can play a vital role in improving customer engagement among SMEs and increase transparency and comparability of information across a wide range of product and services.

Theory of harm 2: Concentration giving rise to market power of some banks leading to worse outcomes for customers

Feedback from our members confirms that they believe that there is a lack of competition within the UK SME banking sector. This has been referenced elsewhere, including by the Independent Commission on Banking, which noted that 85% of SME accounts sat with the 'big four' high street banks. The expansion of SME lenders such as Handelsbanken, Aldermore and Metrobank is welcome news, as is the development of new peer-to-peer and alternative funding models and the divestments from RBS and Lloyds Banking Group. However, these are niche players and SME banking in the UK is likely to continue to be dominated by the major banks for the foreseeable future.

Our members believe that persistent levels of concentration, relatively stable market shares, a market structure characterised by the close links between business current accounts and loans, and high barriers to market entry give rise to competition concerns. In addition to the two main mechanisms indentified by the CMA in relation to unilateral market power through which there might be a link between concentration or market shares and outcomes, we would ask the CMA to consider the impact of market concentration on customer service and efficiency of bank processes. Feedback from our members confirms that the relationship and service component is often more important to SMEs than the price element. The latest BBI survey also found that 85% of businesses believe customer experience is important when they are choosing a bank. Our SME members also talk of the significant differences in the relationship banking experiences between large corporate and SMEs. Large firms often get a tailored one-on-one service, while SMEs typically get a relationship manager with a large portfolio of customers. This approach to SME relationship banking has increased distrust and damaged relationships between SMEs and financial institutions.

We often hear from our members that banks do little to understand small business with lending decisions perceived to be made on a narrow, automated basis with credit scoring often to the fore, rather than on a personal level with decisions made by people with knowledge of their business and the local economy.

Theory of harm 3: Barriers to entry and expansion leading to worse outcomes for customers

In addition to those barriers outlined in the updated issues statement, we believe that there should be a greater focus on reviewing market restrictions for new non-bank SME finance providers including looking at the capital limits for building societies are other barriers to entry into SME banking that need to be addressed. For example, although there are currently 45 building societies with 21 million members in the UK who play a leading role in the personal finances, savings and mortgage markets, they are largely absent from SME banking. This is highlighted in the BBI with just a few building societies appearing in the survey.

More also needs to be done to look at more favourable capital rules for new non-bank SME finance providers, and access to payment systems to help challengers compete with established lenders and reducing barriers for new crowd funders and providers of asset finance.

The BCC remain keen to engage further as this review progresses. For more information please contact: Suren Thiru, BCC UK Economic Advisor, s.thiru@britishchambers.org.uk