Retail banking market investigation: provisional findings report

Appendix 8

Appendix 8.1: Further information about business current accounts

Appendix 8.2: Further information about lending

Further information about business current accounts

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Introduction

1. This appendix provides supporting evidence for Section 8. It covers the following topics:

   (a) Sources of evidence.

   (b) Background on SMEs.

   (c) Transparency and comparability.

   (d) Switching and multi-banking rates.

   (e) Motivations for switching.

   (f) Barriers to switching.

Sources of evidence

2. Throughout Section 8 we use a number of different sources, namely

   (a) Charterhouse BBS (including Charterhouse NI BBS in 2015).

   (b) Charterhouse follow-up surveys covering:

      (i) Finance.

      (ii) Start-ups.

(iii) Two- to five-year old business.

(c) SME Finance Monitor.

(d) The HSBCG survey 2014 and HSBCG survey 2015.

(e) Research Works qualitative research for CMA.

(f) Optimisa qualitative survey for FCA.

3. The main source of quantitative research we used was the Charterhouse BBS and follow-up surveys. These surveys provide a number of insights into SME behaviour. The Charterhouse BBS is a robust large continuous telephone survey which is drawn from a representative sample of the SME population using BCAs. The survey is weighted by turnover rather than employee numbers, which is in line with how banks segment their customers. We report figures from both the Charterhouse BBS (which covers GB) and the Charterhouse NI BBS (where sample sizes allow).[1]

4. The Charterhouse follow-up surveys are much smaller telephone surveys, but cover specific areas of interest. Results of these surveys are representative of the UK,[2] and can be found on the CMA webpages.

5. The SME Finance Monitor is a large continuous telephone survey run by BDRC Continental, mainly focused on access to finance issues. Where we have results from both the SME Finance Monitor and Charterhouse BBS we have tended to use the Charterhouse BBS, partly because it samples from SMEs using BCAs, rather than the population of all SMEs, and also because it is weighted by turnover, rather than employee numbers (as is the case with the SME Finance Monitor). This results in the SME Finance Monitor having a much larger proportion of small businesses (particularly sole traders), with some not using SME banking products. Appendix 8.2 expands on the comparisons between Charterhouse BBS and the SME Finance Monitor.

6. HSBCG has commissioned two surveys, the HSBCG 2014 survey[3] and the HSBCG 2015 survey,[4] both conducted by BDRC Continental. Both these surveys provided helpful insights into SME behaviour. However, we have concerns about the sampling and methodology used as both are sampled from online panels. This is likely to result in a biased sample, especially where questions about the degree of digital engagement are concerned. While we recognise that internet penetration may be high among SMEs, we also note

[1] [✂]
[2] Due to the small number of interviews in NI we do not analyse NI and GB separately.
[3] This was commissioned during the CMA and FCA market study into banking services to SMEs.
[4] This was commissioned during this market investigation.

that the types of individuals that take part in online panels tend to be different from the average internet user. Therefore, where we refer to these surveys, we note the insight they bring but do not place undue weight on the findings. Where the results contradict Charterhouse BBS we place more weight on the Charterhouse BBS results.

Background on SMEs

7. Demand for SME banking services is affected by the demographics of the SME population. For instance microbusinesses tend to have simpler banking needs than larger SMEs who may trade from more than one site and even internationally. This section describes recent trends in SMEs across the UK, including growth of SMEs, changes in the proportion of different SMEs, and entry and exit.

8. The terms of reference for the market investigation defines an SME as a business that, in respect of a given financial year applying to it, has annual sales revenues (exclusive of VAT and other turnover-related taxes) not exceeding £25 million.

9. There are several alternative definitions of SMEs that are commonly used. Most commonly, an SME is defined as a business with 250 employees or fewer.[5] The Companies Act 2006[6] defines a business as an SME if two or more of the following requirements are satisfied, in both the current and preceding financial year:

   (a) Number of employees – not more than 250 employees.

   (b) Turnover – not more than £25.9 million net (or £31.1 million gross).

   (c) Balance sheet total – not more than £12.9 million net (or £15.5 million gross).[7]

10. SMEs currently account for over 99% of all businesses and produce 47% of all UK turnover (see Table 1).[8]

Table 1: Number of businesses in the UK private sector and their associated employment and turnover by size of business, start of 2014

	Businesses	*Employment (000s)*	*Turnover*(£)*

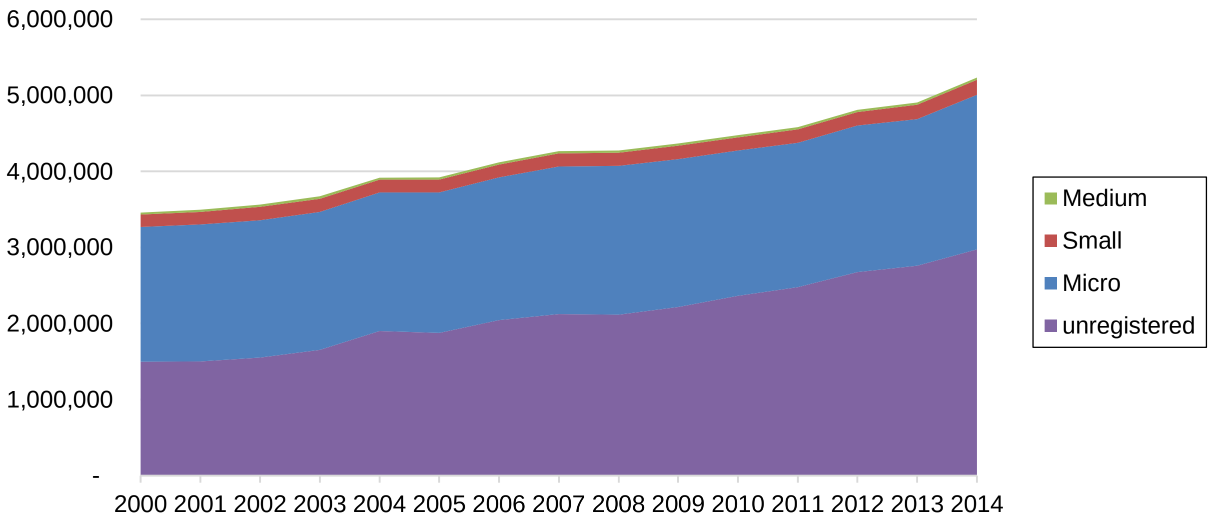
[5] National statistics from ONS and BIS tend to use this definition.
[6] See section 465, Companies Act 2006.
[7] EU (under Recommendation 2003/361/EC) defines SMEs as enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding €50 million, and/or an annual balance sheet total not exceeding €43 million.
[8] See BIS, Business population estimates 2014, Table 26.

All businesses	5,243,135	25,229	3,521,254
SMEs (0–249 employees)	5,236,390	15,159	1,647,201
Of which			
With no employees†	3,965,775	4,353	231,143
1–9	1,044,385	3,923	424,299
10–49	194,755	3,807	514,895
50–249	31,475	3,075	476,864

Source: Business Population estimates 2014, BIS.
*Total turnover figures exclude Section K (financial and insurance activities) where turnover is not available on a comparable basis.
†'With no employees' comprises sole proprietorships and partnerships comprising only the self-employed owner-manager(s), and companies comprising only an employee director.

11. Since the recession in 2008 there has been a rise in the number of SMEs, up from approximately 4.3 million in 2008 to 5.2 million in 2014.

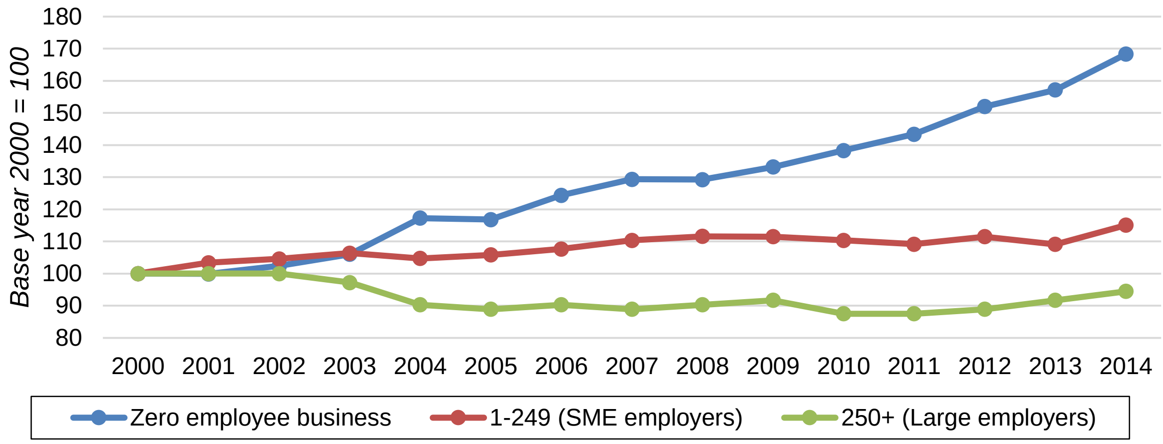
Figure 1: Growth in SMEs by employee numbers (UK), 2000–2014



Source: Business Population estimates 2014, BIS.

12. Much of this growth has been among SMEs with zero employees. Since 2008, the number of zero employee businesses has grown by 30%. The growth rate has been much slower among SMEs with at least one employee, with just 3% more in 2014 compared to 2008 (see Figure 2). Zero employee businesses will tend to have simpler banking needs than larger SMEs.

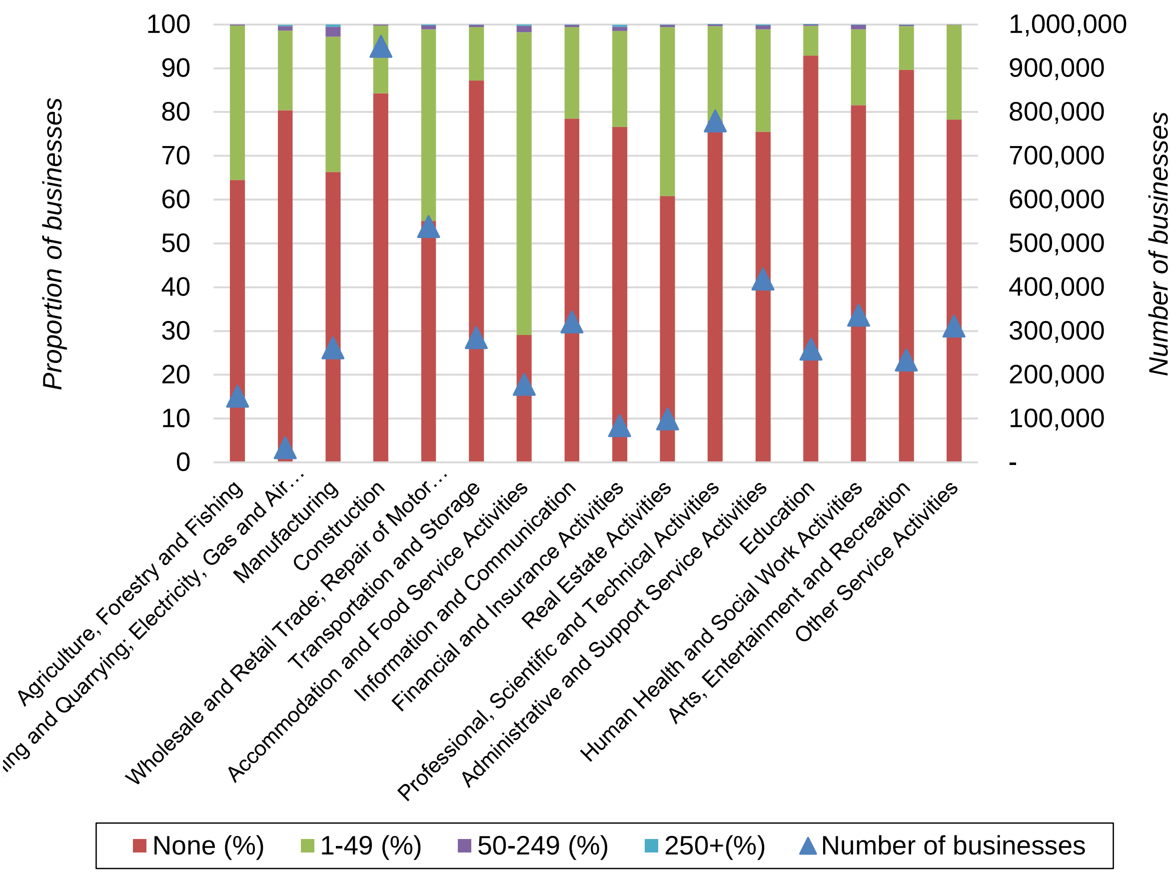
Figure 2: Growth of UK business numbers (2000–2014)



Source: Business Population estimates 2014, BIS.

13. SMEs are also active in every sector of the economy across the UK with the highest numbers in the construction and the professional, scientific and technical sectors.

Figure 3: Number and proportion of UK businesses in each sector (2014)

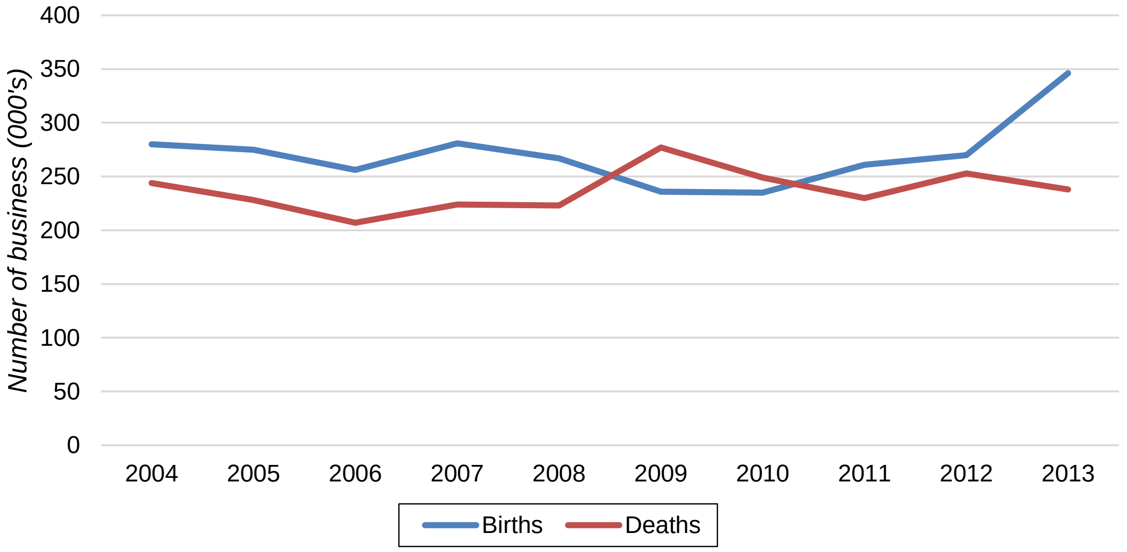


Source: Business Population estimates 2014, BIS.

Note: The second column is 'Mining, Quarry and Utilities', and the 5th column is 'Wholesale and Retail Trade, Repair of Motor Vehicles and Motorcycles'

14. Whilst Figure 1 shows how many SMEs there are, this number hides the dynamism in the number of SMEs. Each year new businesses start trading (births) and stop trading (deaths).[9] Figure 4 shows the number of business births and deaths between 2004 and 2013.

Figure 4: UK Business births and deaths (2004–2013)



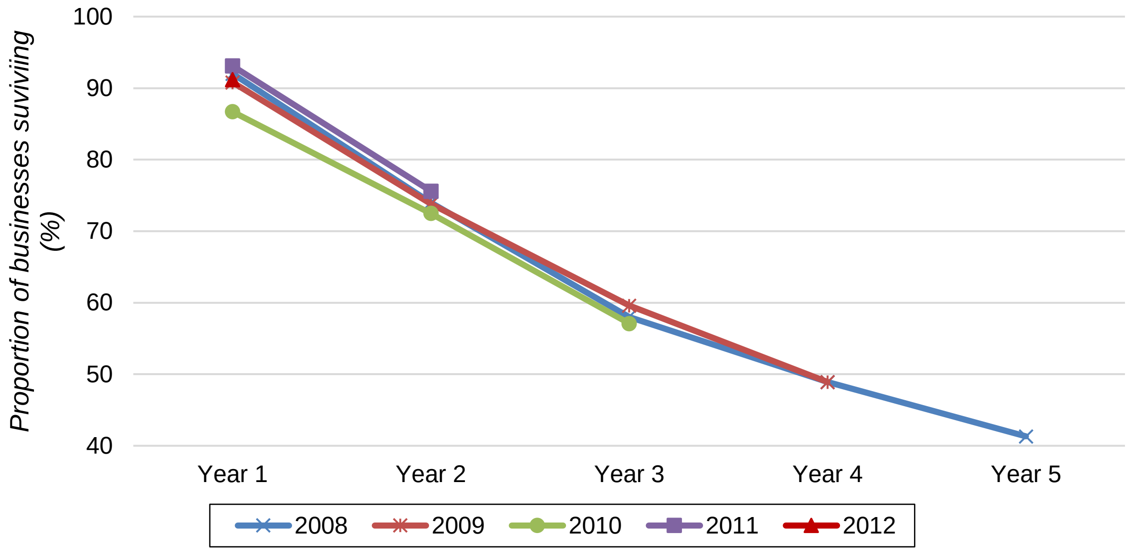
Source: ONS Business Demography.
Note: This only includes businesses that are registered and does not take account of the whole of the business population. However, registered businesses are the ones most likely to have a BCA.

15. In 2013 there were approximately 346,000 new businesses (business births), which equates to around 14% of the business population. For most of this period, births have been above deaths, reflecting a growing number of businesses and SMEs. However, in 2009/10 the number of business deaths increased and business births decreased. This coincided with the recession in this period.

16. After the first year of a business being born survival rates are above 90%. However by year 3 this has dropped off to 60% and by year 5 less than half (around 40%) survive. This degree of churn is likely to be reflected in the degree of churn in BCAs.

[9] In addition, businesses can expand beyond the size of an SME.

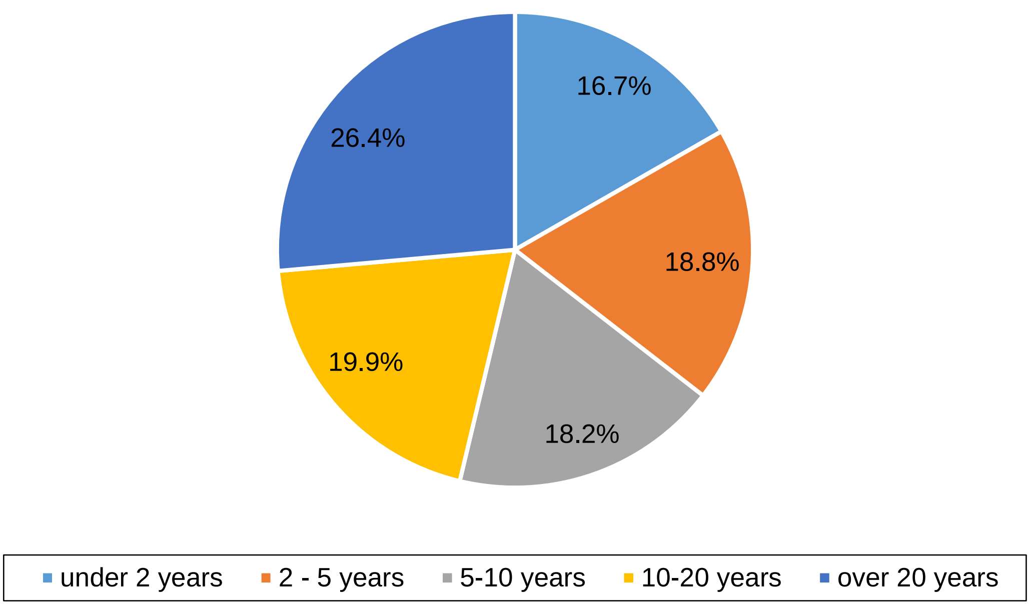
Figure 5: UK Yearly business survival rates (2008–2012)



Source: ONS Business Demography, 2013.

17. While there is considerable churn with younger businesses, this drops off as businesses grow older. 26% of SMEs are over 20 years old, and 46% over ten years old, while 36% are under five years old.

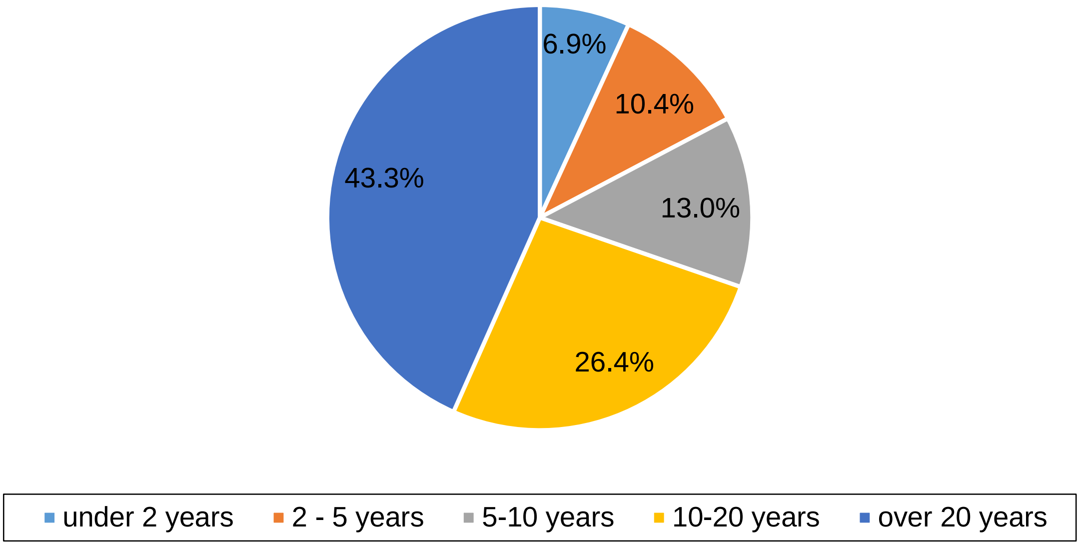
Figure 6: Age of SMEs in GB



Source: Charterhouse BBS.
Base: All SMEs (14,239).

18. The age profile of SMEs in NI is quite different from the profile in GB, with a greater proportion of older SMEs.

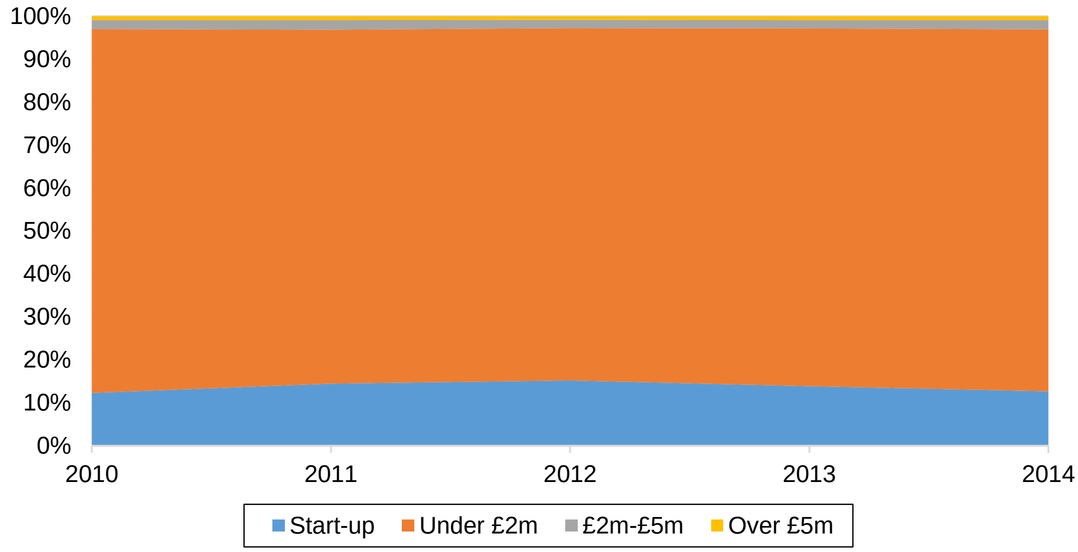
Figure 7: Age of SMEs in NI



Source: Charterhouse NI BBS, 2015.
Base: All SMEs (808).

19. The proportion of start-ups and established SMEs holding a BCA has remained relatively stable over time.

Figure 8: Turnover profile of SMEs in GB over time (2010–2014)



Source: Charterhouse BBS 2010–2014.
Base: All SMEs 2010 (15,883), 2011 (16,188), 2012 (15,746), 2013 (15,838), 2014 (14,239).
Note: Some SMEs use a PCA rather than a BCA so the number of businesses may be higher. However the Charterhouse BBS only asks about SMEs with a BCA account.

Differences between SME banking and personal banking

20. Whilst there are many similarities between PCAs and BCAs, there are some key differences.

(a) *Payments in and out*: In a PCA, there tends to be one main payment in (salary) with a number of payments, including direct debit and standing orders, out of the account. However, with a BCA, there can be payments in from a number of different customers and sources.

(b) *Authorised overdrafts:* The majority (64%) of PCA customers have an authorised overdraft facility with their PCA.[10] They will only pay for this facility when they use it. For SMEs, 43% have an authorised overdraft facility.[11] This has to be arranged yearly and an arrangement fee is generally charged by the banks, as well as the usage charges.

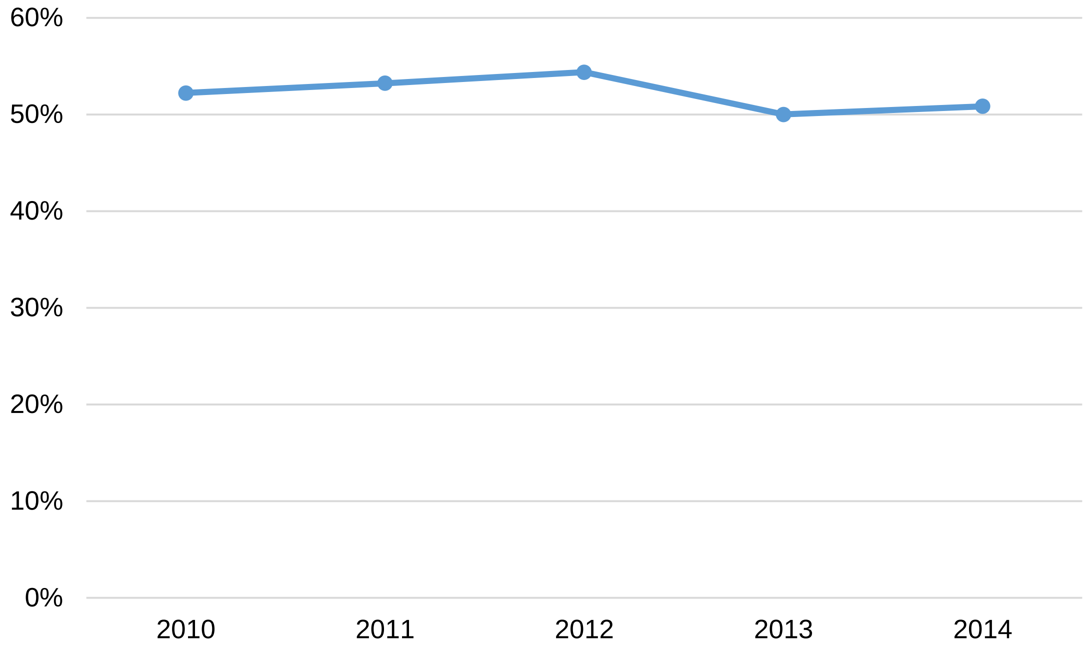
(c) *Free banking:* Many PCAs are operated on a FIIC basis. This means that account maintenance fees and core transaction fees are zero. Most BCAs, except for the initial free banking periods for start-ups and switchers, are paid through account maintenance fees, transaction fees, or both.[12]

(d) *Relationship banking:* Relationship banking is a more prominent feature of SME banking than for personal banking. For most PCA customers,[13] contact with the bank is primarily through digital channels, with branch staff, or with telephone operators. As set out in Table 2, larger SME customers will generally have a dedicated relationship manager. Smaller SMEs will generally have access to dedicated business centre support, but not an individual relationship manager. Larger SME customers may use their bank for a wider range of services and expect advice from their bank through relationship managers.

21. Figure 9 shows that just over 50% of SMEs open a BCA with their PCA provider.[14] [✄][15]

[10] See Appendix 7.4.
[11] Charterhouse BBS 2014.
[12] See Section 9 for more details about free banking periods for SMEs.
[13] The main exception is private banking for wealthy personal customers.
[14] Charterhouse BBS 2014.
[15] [✄]

Figure 9: Proportion of start-up SMEs in GB opening a BCA with their PCA provider (2010–2014)



Source: Charterhouse BBS 2010–2014.
Base: All start-ups: 2010 (3,711), 2011 (4,227), 2012 (3,933), 2013 (3,908), 2014 (2,556).
Note: This chart displays the proportion of all start-up SMEs that opened their BCA with their PCA provider .

Segmentation

22. The variety of needs of SMEs is also reflected in the way in which banks segment customers based on the size of the business. This segmentation influences the products available and the degree of negotiation on tariffs, as well as the level of support and the quality of the relationship. The five largest banks generally serve SMEs across two business units: business banking and commercial banking.

(a) Business banking covers around 95% of SMEs and is generally for smaller businesses with turnover up to around £2 million (see Table 2 below).[16] These SMEs, particularly those at lower turnovers in this band, will tend to have simple banking needs, often requiring a transactional relationship with their banks (eg making payments, cash handling). Some of these SMEs will get access to relationship managers, albeit as part of a large portfolio. Start-ups will tend to get a period of free banking.

(b) Commercial banking serves the remaining businesses (around 5%) and generally includes SMEs with turnover above £2 million. These SMEs will often have a greater degree of financial sophistication (including

[16] Names of organisational units and exact turnover splits vary by bank (see Tables 2 and 3).

employing specialist financial management staff) and are more likely to require a wider range of products and services than those required by smaller SMEs. SMEs with turnover greater than £2 million will generally also be provided with a relationship manager by their bank. These customers will tend to generate more revenue for banks (see Table 5 in Appendix 6.2).

Table 2: Turnover segmentation by five largest UK banks

<table>
<tr><th>Bank</th><th><£250k</th><th>£250k–£500k</th><th>£500k–£1m</th><th>£1m–£2m</th><th>£2m–£5m</th><th>£5m–£10m</th><th>£10m–£25m</th></tr>
<tr><td rowspan="2">Barclays*</td><td colspan="7">[✂]</td></tr>
<tr><td colspan="7">[✂]</td></tr>
<tr><td rowspan="2">HSBC</td><td colspan="5">Business Banking
[✂]</td><td colspan="2">Mid-Market Enterprise
[✂]</td></tr>
<tr><td colspan="2">[✂]</td><td colspan="2">[✂]</td><td>[✂]</td><td colspan="2">[✂]</td></tr>
<tr><td rowspan="2">Lloyds</td><td colspan="3">Retail Business Banking</td><td colspan="4">SME Banking</td></tr>
<tr><td colspan="3">Multi-channel model</td><td>[✂]</td><td colspan="2">[✂]</td><td>[✂]</td></tr>
<tr><td rowspan="2">RBS/
NatWest†</td><td colspan="4">Personal & Business Banking</td><td colspan="3">Commercial & Private Banking</td></tr>
<tr><td>[✂]</td><td>RM Hub
[✂]</td><td colspan="2">Dedicated RM
[✂]</td><td colspan="3">Dedicated RM
[✂]</td></tr>
<tr><td rowspan="2">Santander‡</td><td>Business Banking</td><td colspan="6">Commercial Banking</td></tr>
<tr><td>Direct model with local business manager support</td><td colspan="3">RM support (£250k-£2.5m)
[✂]</td><td colspan="3">Relationship director (£2.5m+)
[✂]</td></tr>
</table>

Source: Banks' data.
*[✂]
†[✂]
‡[✂]
Note: Numbers in brackets represent the range or average size of an RM's (relationship manager) portfolio.

23. However, the segmentation in Table 2 hides some nuances about how banks approach segmentation.

(a) *Borrowing requirements:* both LBG and RBSG also use borrowing thresholds to segment customers. This means that business banking customers with larger borrowing requirements will be dealt with by the commercial banking segment.

(b) *Community/charity accounts:* Many banks provide accounts for charities, clubs or societies. Barclays, HSBCG and LBG also have accounts for schools and other educational establishments. Such accounts are generally provided free for in credit customers.

(c) *Sector focus:* Some banks (most notably LBG, RBSG and Santander) have a focus on certain sectors including agriculture, healthcare, property and professional services. In addition, LBG has specialists in the manufacturing sector, whilst Santander has specialists in the renewable energy sector. HSBCG also has a banking division for real estate SMEs.

24. Both LBG and HSBCG have reviewed their way of segmenting SMEs and have sought to align services on a needs basis. This has resulted in greater provision of relationship managers for larger (and more complex) SMEs and a more multi-channel approach in both provision of relationship managers and other channels for smaller SMEs. For instance LBG told us that:

> It was recognised that LBG's smaller SME customers had simpler needs that could be better served through dedicated propositions with a particular focus on simplicity, transparency and accessibility, as well as demonstrating good value for money. The SME proposition focuses on building relationships with SMEs and communities, providing access to experts in banking and supporting clients' business goals. The new operating model, therefore, delivers two complementary approaches within a single bank: a Relationship Manager (and support team) model for larger SMEs (and those with more complex needs) focused on smaller portfolios and involving frequent contact with LBG staff; and a multi-channel banking model in retail business banking for smaller SMEs (with more straightforward needs) with access to business specialists when required.

25. In addition Santander has now moved to ‘needs based’ segmentation where SMEs were grouped by the services and the support they required, regardless of their turnover. Banks’ relationship management strategies and how these have changed over time, are considered further in Appendix 9.1.

26. Whilst the large banks primarily segmented their customers based on turnover, the smaller banks used a variety of approaches, including turnover, borrowing requirements and tailored approaches. For instance, both [✂] and Ulster segmented customers based on turnover (below £2 million and above £2 million), although they also focussed on some specific sectors. Clydesdale use borrowing requirements to segment customers.

27. Some of the other banks appeared to have less prescriptive segmentation. TSB stated that it had no particular sectors it targeted, although there were some sectors it would not provide a BCA to. Co-op told us that it targeted customers that met its risk and ethical criteria. Handelsbanken said that it did

not segment either by size or sector and its services and products were tailored to the needs and requirements of the individual customer.

28. In NI, segmentation by banks was generally borrowing based rather than turnover based (see Table 3). However, both [✄] and Ulster also used turnover as well as borrowing to determine which part of the bank a customer was serviced by.

Table 3: Bank segmentation of SMEs in NI

Bank (borrowing)	*<£25k*	*£25k–£150k*	*£150k–£250k*	*£250k–£1m*	*£1m–£20m*
AIB	[✄]	[✄]	[✄]		[✄]
BoI	[✄]			[✄]	
Danske	[✄]	[✄]			[✄]
Ulster		[✄]		[✄]	

Source: Banks' data.

Transparency and comparability

29. Transparency and comparability of information is important to enable SMEs to make effective choices. In this section we present further evidence on:

(a) sources of information;

(b) financial sophistication; and

(c) comparison tools.

Sources of information

30. Banks told us that information about product prices and charges were available from multiple sources. First, the banks noted that the providers themselves are a main source of information and SMEs could find out about prices and charges:[17]

- online: on provider websites, via webchat, or through some online tariff calculators;

[17] Webchat and tariff calculators were specifically mentioned by HSBCG.

- in branches: in leaflets and brochures, or by speaking to branch based relationship or business managers;
- over the telephone with relationship or business managers; and
- by arranging an appointment with a relationship manager.[18]

31. Second, the banks said that PCWs contained information on product prices and charges.

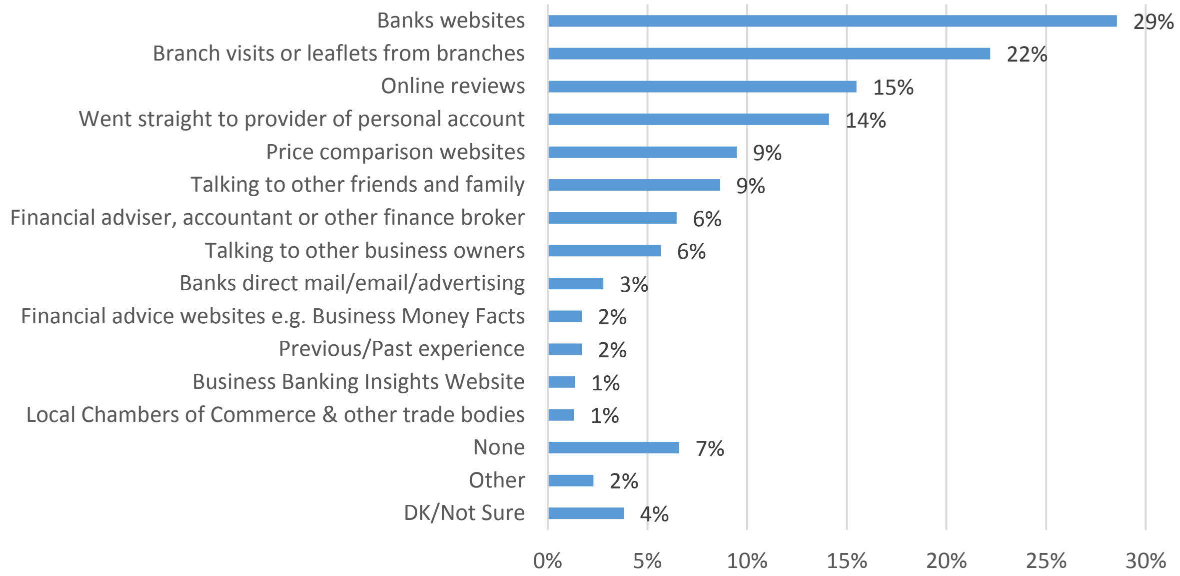
32. Third, LBG told us that many start-ups retained formation agents to manage the company process which, in many cases, included advice in relation to acquiring banking services. RBSG noted that partner blog sites will feature some of their details on start-up products.[19] We note that some of these websites will have a link to a particular bank offering a discount (cashback) when opening their BCA, although the amount of information they provide about the BCA is limited.

33. Other sources of information include brokers and professional advisers such as financial advisers, accountants and lawyers. Similarly, trade associations and organisations such as the FSB and the British Chambers of Commerce provide advice and information to their members.

34. In the Charterhouse follow-up survey of start-up SMEs the most common source of information mentioned by SMEs was the bank's own website (29%), visiting a branch (22%) and using online reviews (15%) (see Figure 10).[20]

[18] These may occur at the customers' premises.
[19] Examples of these formation, start-up and blog sites are: Startups.co.uk, Smarta.co.uk, theformationscompany.com, although there are many others.
[20] See page 9 of SME Follow up Survey results.

Figure 10: Sources of information considered when choosing a BCA bank, UK



Source: Charterhouse follow-up survey of Start-ups, Question B5 (multicode).
Base: All (252).

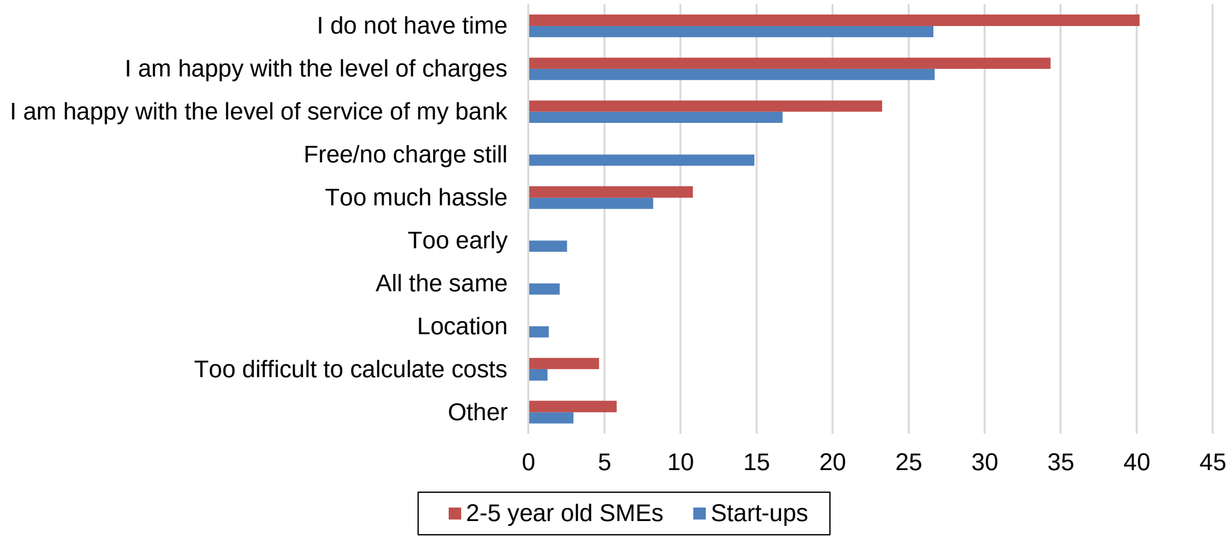
35. The HSBCG survey 2015 found that searching online was a quicker method of searching than visiting a brand or phoning a bank and online searching required lower effort. However, 40% who used branches said they definitely had enough information to make a decision, compared to 26% for those searching online or phoning a bank.[21]

Reasons for not comparing BCA costs

36. Figure 11 shows that for both start-ups and 2-5 year old SMEs, the main two reasons for not comparing costs were “I do not have the time” and “I am happy with the level of charges”.

[21] HSBCG survey 2015

Figure 11: Why SMEs do not compare costs (UK)

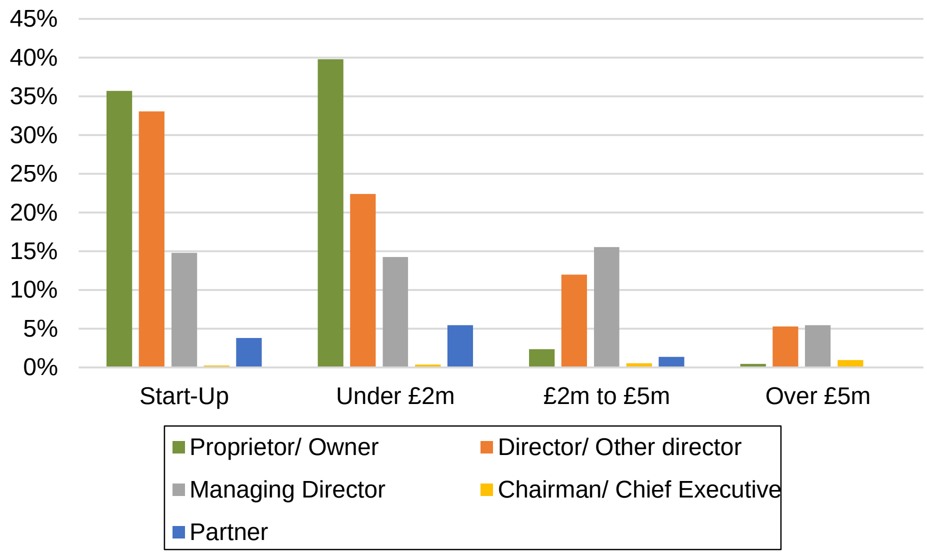


Source: Charterhouse follow-up surveys (start-ups – E5 and 2–5 year olds – E4).
Base: All SMEs who do not compare costs with other BCA providers; survey of start-ups (211), survey of 2–5 year olds (185).

Financial sophistication

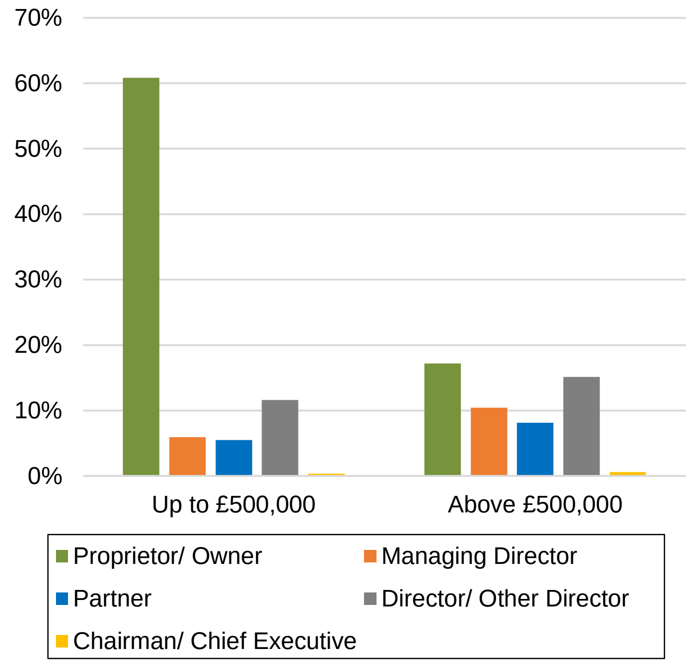
37. Figure 12 shows that smaller SMEs are substantially more likely to have the owner or director responsible for finance matters. This is not perhaps surprising, given many of these SMEs will be zero employee business with just one owner/director.

Figure 12: Job title of person responsible for finance decisions, GB (owner/leadership positions)



Source: Charterhouse BBS 2014, Qa2b.
Base: All SMEs: start-ups (2,920), under £2 million (8,938), £2 million to £5 million (967), over £5 million (1,414).

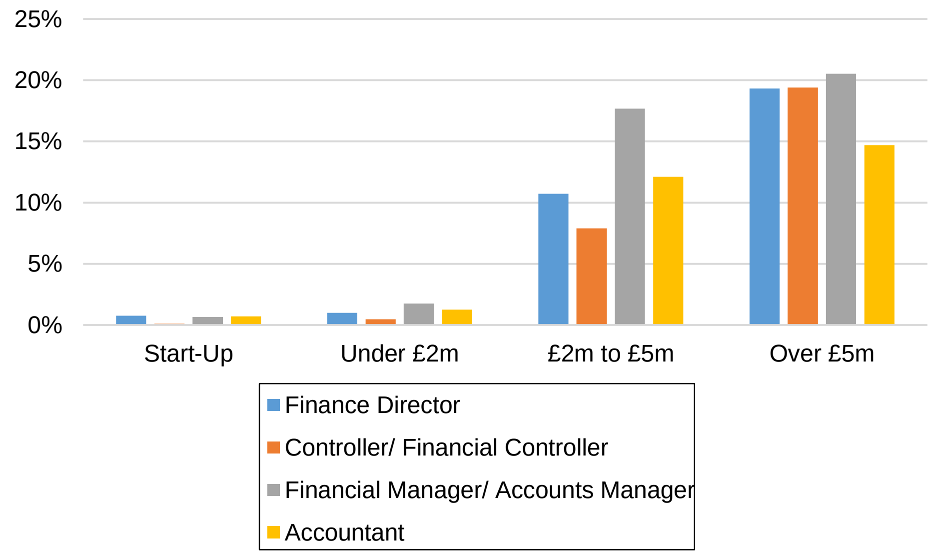
Figure 13: Job title of person responsible for finance decisions, NI (owner/leadership positions)



Source: Charterhouse NI BBS, 2015.
Base: All SMEs: up to £500,000 (658), above £500,000 (150).
Note: Due to the smaller sample size in NI it was only possible to make comparisons by size for SMEs over and under £500,000 turnover.

38. By contrast, large SMEs are substantially more likely to have someone finance related responsible for finance decisions (see Figure 14).[22]

Figure 14: Job title of person responsible for finance decisions, GB (financial and other positions)

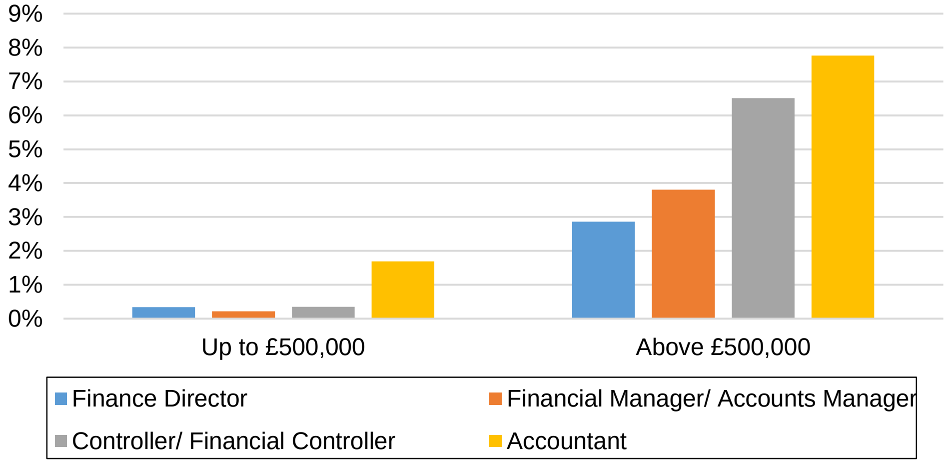


Source: Charterhouse BBS 2014
Base: All SMEs: start-ups (2,920), under £2 million (8,938), £2 million to £5 million (967), over £5 million (1,414).

[22] This appears less true in NI, although this can be partly explained by the sample having a lack of larger SMEs.

Note: Non-financial positions not shown.

Figure 15: Job title of person responsible for finance decisions, NI (financial and other positions)



Source: Charterhouse NI BBS.
Base: All SMEs: up to £500,000 (658), above £500,000 (150).
Note: Non-financial positions not shown.
Note: Due to the smaller sample size in NI it was only possible to make comparisons by size for SMEs over and under £500,000 turnover.

Price Comparison Websites

39. We discuss PCW's functionality and financial viability below.

PCW functionality

40. We are aware of five different PCWs covering BCAs.

- Business Moneyfacts covers BCAs, deposit accounts and loans but only offers best buy tables, rather than the ability to search the comprehensive list of accounts it holds data on.
- Business Account Finder uses data on product characteristics and charges from Business Money Facts.[23]
- Knowyourmoney.co.uk compares accounts for a number of different providers.
- Money.co.uk provides comparisons on a range of SME targeted products including loans and current and deposit accounts. Comparisons are based on basic charges such as monthly account fee, interest paid and eligibility for the account. SMEs can click through to the banks' websites to find out

[23] See Section 8 for information on the Business Account Finder.

more about the detailed transaction charges, although money.co.uk told us that it was developing tools to enhance the comparison experience.[24]

- Moneysupermarket.com also provides comparisons on a range of SME targeted products including loans and current and deposit accounts. Comparisons are based on basic charges such as monthly account fee, interest paid, and eligibility for the account. Moneysupermarket.com also allows comparisons for overdrafts. Moneysupermarket.com provides more detailed information on some charges when individual BCAs are selected, but it is not possible to search by these criteria or compare on one screen.

Financial viability of PCWs

41. For PCWs to be financially viable, we would expect there would need to be sufficient demand for their services and for them to be able to monetise the demand. PCWs typically are financed by advertising revenues and click-through and sales agreements whereby the PCW receives payment for each account that is clicked on its search/comparison page (Cost Per Click (CPC) sales) and/or a larger amount for each accepted application to the bank (Cost Per Acquisition (CPA) sales).

42. [✂] Appendix 7.3 includes a comparison of revenues and visits for energy and motor insurance comparison pages with PCAs from Confused.com. [✂]

43. Table 4 shows that while there has been an increase in the number of visits, the number of click-throughs and revenues has remained static.

Table 4: PCW visits, click-throughs, and revenues 2013 and 2014

	Visits		*Click-throughs*		*Revenues*	
	2013	*2014*	*2013*	*2014*	*2013*	*2014*
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: CMA analysis of Business Money Facts and money.co.uk responses to PCW questionnaire.

44. Table 4 also shows that the number of visits in 2014 is [✂], which compares to 4.8 million active BCAs. This suggested usage of PCWs was low among SMEs.

[24] [✂]

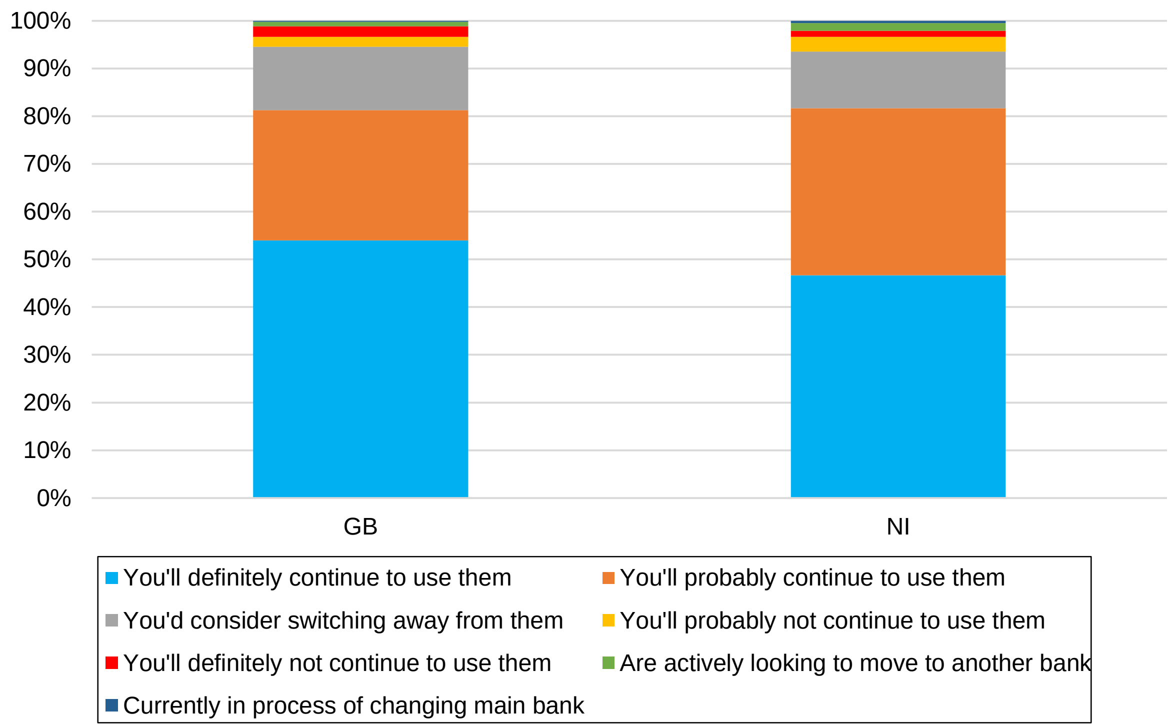
Switching

45. In this section we look at the degree to which customers consider switching, barriers to switching, switching levels and multi-banking.

Consideration of switching

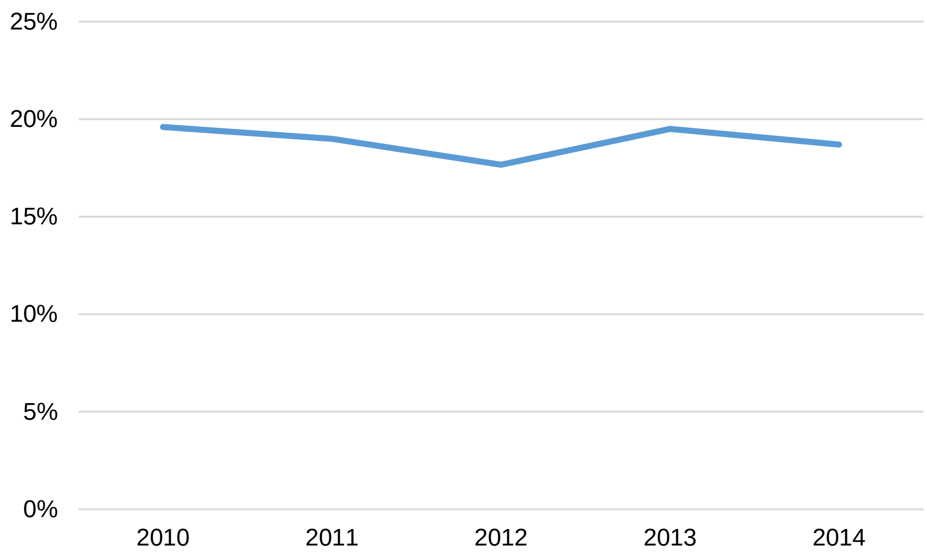
46. Figure 16 shows the number of SMEs that are considering switching away from their current bank in the coming year, in both GB and NI, while Figure 17 displays the proportion over time for GB only.

Figure 16: Whether SMEs would consider switching in the coming year, GB and NI



Source: Charterhouse BBS 2014 and Charterhouse NI BBS, P3.
Base: All SMEs asked: GB (10,132), NI (808).

Figure 17: Whether SMEs would consider switching in the coming year over time, GB



Source: Charterhouse BBS 2014.
Base: All SMEs asked: 2014 (10,132), 2013 (11,274), 2012 (11,277), 2011 (11,705), 2010 (10,827).
Note: Consider switching is all those who said they were currently in the process of switching, actively looking to move bank, definitely would not continue to use their current bank, would probably not continue to use their current bank, and were considering switching away at question P3.

47. The HSBCG survey 2015 found that 32% of SMEs have considered switching BCA in the last 2 years. Consideration of switching in the last two years was higher amongst the £500k-£2m and £2m-£25m groups compared to the <£500k group, although lower consideration of switching was found amongst older SMEs.

Barriers to switching

CASS awareness

48. Evidence suggested there was low awareness of CASS.

(a) The FCA's CASS qualitative research:

> highlight[ed] the lack of awareness of CASS, particularly amongst businesses and charities. The research suggested that CASS had been more visible to consumers than businesses and charities; there was recall of advertising for CASS that appeared to predominantly target consumers, and recollection of the CASS logo appearing in advertising for high street banks. In addition to

this, some financial news sources were seen to have helped to create noise about CASS in the consumer world.[25]

(b) Payments Council research in 2014 suggested slightly higher awareness. It found that 49% of those businesses that had not switched accounts recently were aware that there was assistance available to them from the banks to help them switch accounts, although 61% of those businesses said that they knew little or nothing about what assistance was provided. The research results indicated that between 62% and 88% of SMEs were aware of the various aspects of CASS).

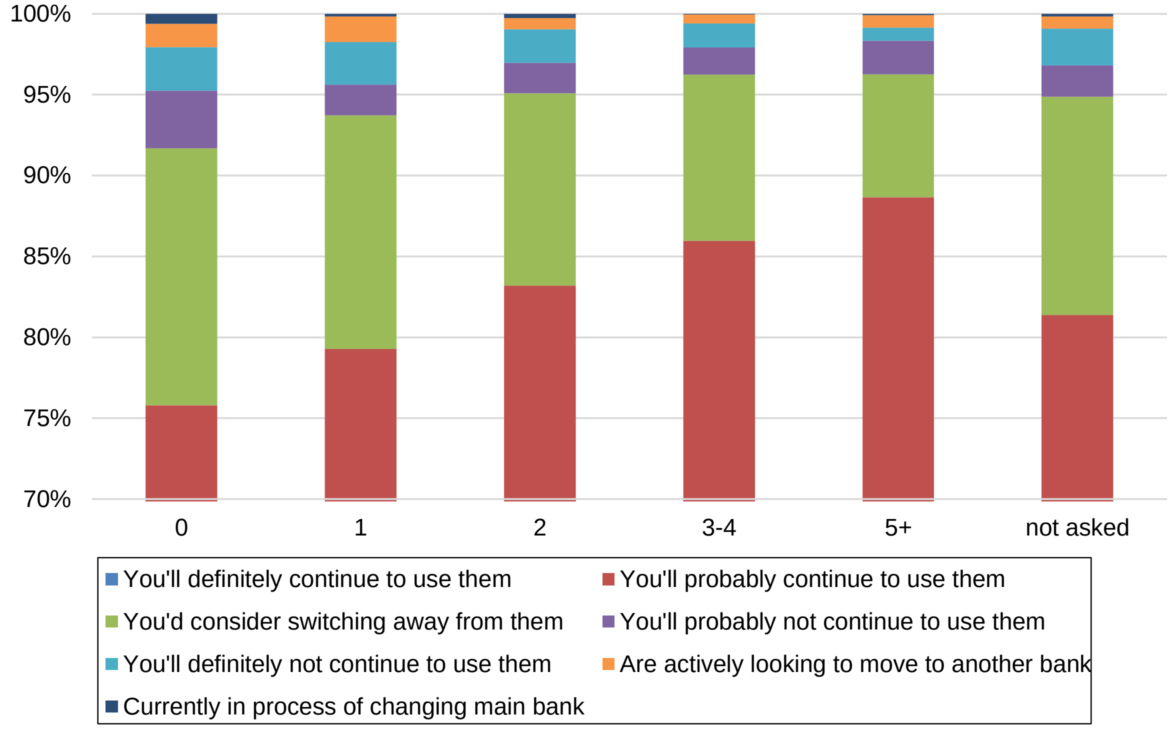
(c) The HSBCG survey 2014 found that a large number of SMEs still did not know about CASS, with 57% of switchers, 71% of considerers[26], 71% of non-considerers[27] not aware of CASS, or thought it applied only to PCAs. CASS made it more likely for 57% of considerers, 42% of switchers and 21% of non-considerers to consider switching providers.

Multi-product holdings

49. The Charterhouse BBS showed that SMEs were less likely to consider switching when they held additional products with their bank.

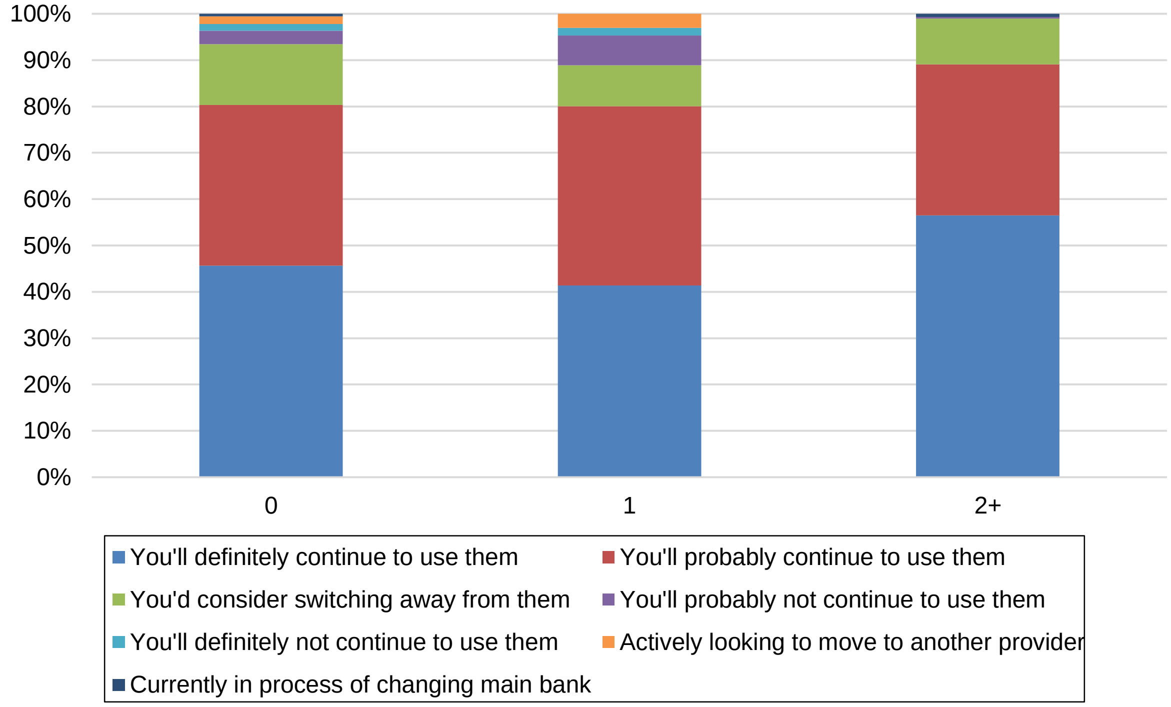
[25] Optimisa Research, *Engagement with current accounts and the switching process*, pp44 & 45.
[26] That is, SMEs considering switching but did not ultimately switch.
[27] That is, SMEs that didn't consider switching.

Figure 18: Switching consideration by number of products held by SMEs with their main bank in GB



Source: Charterhouse BBS.
Base: All SMEs asked about products held 2014: 0 (907), 1 (1,137), 2 (1,055), 3–4 (1,175), 5+ (718).
Note: The number of other products are those the SME has held in the last 12 months at its main bank in addition to a BCA and overdraft.

Figure 19: Switching consideration by number of products held by SMEs with their bank in NI



Source: Charterhouse NI BBS.
Base: All SMEs; 0 other products (538), 1 other product (134), 2+ other products (136).

Note: The number of other products are those the SME has held in the last 12 months at its main bank in addition to a BCA and overdraft (if it had one).

Levels of switching

50. Annual switching rates were estimated at around 4% in 2014. This followed a decline in switching after the recession, where switching rates fell from 6% in 2010 to 4% in 2012.[28] This compares with earlier estimates of switching, including the ICB report, which found that annual switching rates among SMEs were between 3 and 6% over the period 2005 to 2009.[29]

51. Estimates of switching through CASS were much lower than survey estimates.[30] In total only around 0.4% of the total number of active BCAs switched their BCA through CASS in 2014.[31]

52. CASS figures are likely to underestimate the total number of business switching because of two main reasons.

    (a) CASS does not cover all SMEs. When CASS was initially implemented in September 2013 it only covered businesses with an annual turnover and/or balance sheet total that did not exceed €2 million (or sterling equivalent) and fewer than ten employees, approximately 95% of the SME population. From March 2015, this has changed so that SMEs with turnover up to £6.5 million are able to use CASS. This covers 99% of the overall SME population.

    (b) Some SMEs may not be using CASS to switch their bank account because they are unaware of the service.

53. In addition, the Payments Council conducted research on SME switching to monitor the effects of CASS.[32] While this research only covered businesses with a turnover less than £1.8 million and fewer than nine employees, it found that 2.3% of businesses had switched in 2014 and a further 12% had considered switching but had not done so.

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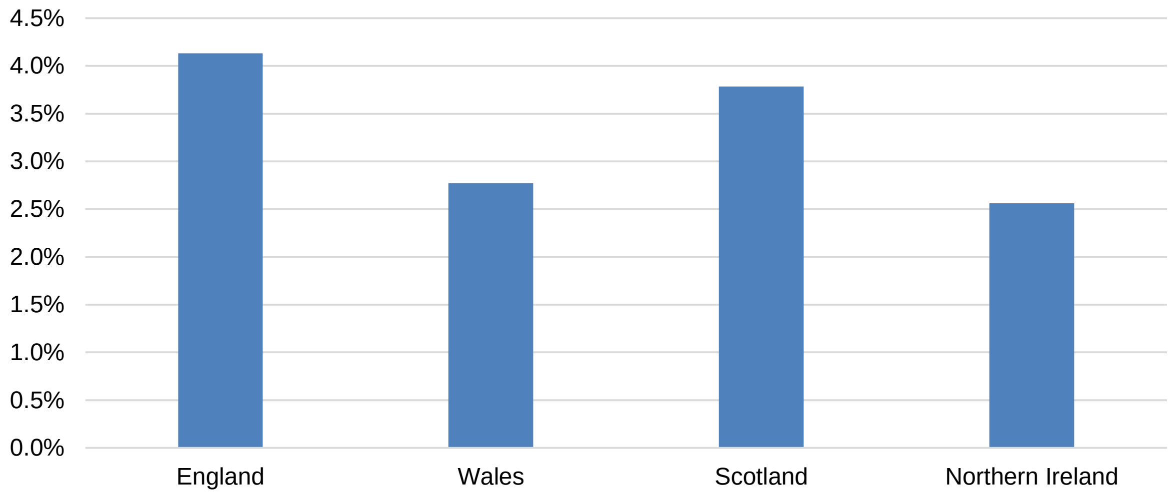
[28] Charterhouse asked respondents: 'Have you changed your main bank over the past 12 months?' Whilst the main bank does not necessarily mean the BCA provider, 96% of businesses named their main bank as their BCA provider.
[29] ICB report, p180. ICB based its estimates of switching on TNS RI Small Business Banking Survey Great Britain. It only covered businesses with turnover up to £1 million.
[30] In September 2013, the CASS was launched which enabled consumers and the majority of SMEs to switch current accounts in seven days, guaranteeing the switch against any financial losses and redirected old payments to the new account.
[31] This equates to 22,452 SMEs.
[32] See Payments Council research. Because of the focus on CASS, businesses with turnover higher than £1.8 million or more than nine employees were excluded from the research. Therefore, the switching estimates reflect the rate of switching among microbusinesses only.

SME switching by region

54. There is some variation in switching by nation, with switching rates in NI appearing to be lower than in England (see Figure 20).

Figure 20: Switching rates by nation (2014)



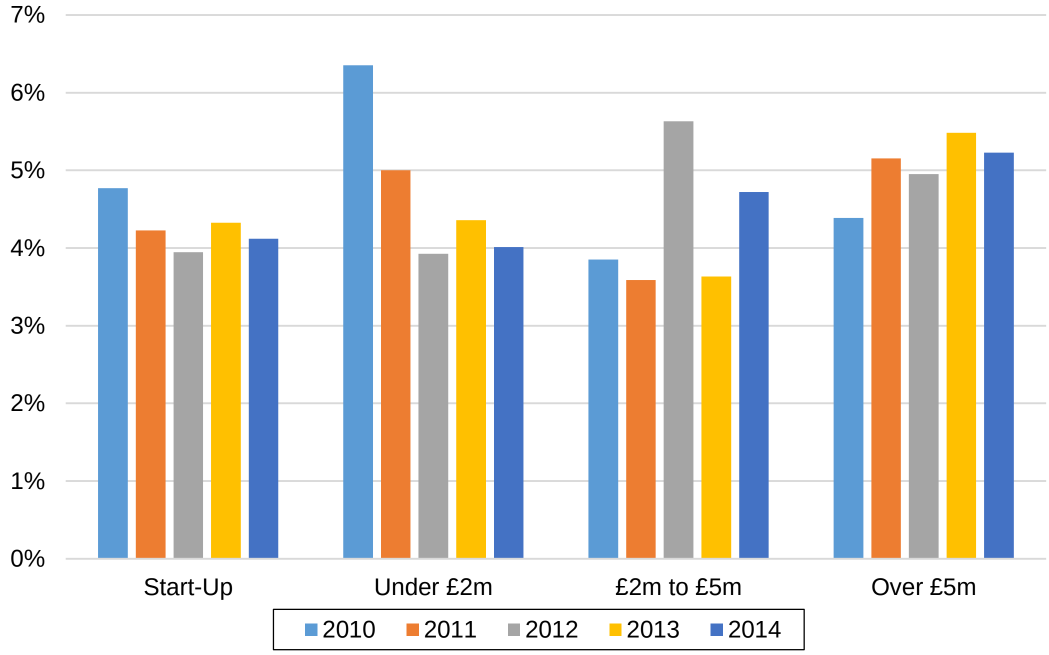
Source: Charterhouse BBS 2014, Charterhouse NI BBS 2015.
Base: England (11,075), Wales (527), Scotland (2,637), NI (808).
Note: The switching rates in Wales and Scotland are not statistically significantly different from England at the 0.05 significance level.

SME switching by type of SME

55. There is evidence that switching rates vary between different types of SMEs. Figure 21 shows switching rates by turnover across years for GB, and Figure 22 shows switching rates by turnover for NI in 2015. The difference between those with annual turnover over £5 million and those with annual turnover under £2 million in GB is not statistically significant, despite the slightly higher switching rates in the survey.[33] In 2010 switching rates were highest among businesses with a turnover under £2 million. Switching rates for this group have since declined. Much of the decline in the overall headline rate of switching seems to have been driven by a decline in switching rate of SMEs with turnover under £2 million.

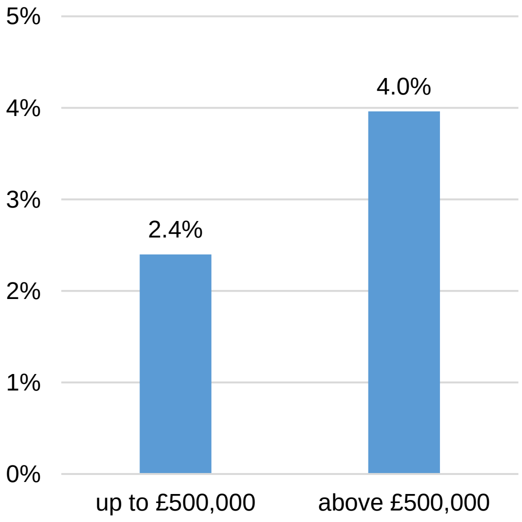
[33] The same applies to NI, where the difference between the rates for SMEs over and under £500,000 turnover is not statistically significant.

Figure 21: Switching rate by turnover (2010–2014), GB



Source: Charterhouse BBS 2010–2014.
Base: All start-ups: 2010 (4,408), 2011 (4,731), 2012 (4,337), 2013 (4,379), 2014 (2,920); all SMEs under £2 million: 2010 (9,128), 2011 (9,093), 2012 (9,100), 2013 (9,073), 2014 (8,938); all SMEs £2 to £5 million: 2010 (922), 2011 (971), 2012 (920), 2013 (938), 2014 (967); all SMEs over £5 million: 2010 (1,425), 2011 (1,393), 2012 (1,389), 2013 (1,448), 2014 (1,414).

Figure 22: Switching rate by turnover NI (2015)



Source: Charterhouse NI BBS, 2015.
Base: All SMEs up to £500,000 (658), above £500,000 (150)
Note: Due to the smaller sample size in NI it was only possible to make comparisons by size for SMEs over and under £500,000 turnover.

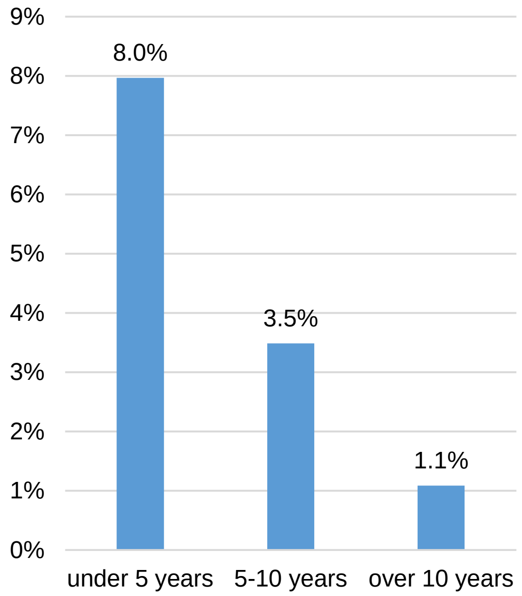
56. Figure 23 shows that generally switching rates also appear to be higher for businesses aged between two and five years old. Switching rates among older businesses over ten years old appear to be relatively low both in GB and NI.

57. One potential explanation for why switching rates might be higher for businesses aged between two and five years is the end of free banking. Typically start-ups will receive a period of free banking lasting between 18 months and two years, after which they are charged for the use of their BCA. This can sometimes act as a prompt to switch bank to reduce or avoid charges. This is explored in more detail below under motivations for switching in paragraphs 87 to 124.

Figure 23: Switching rates by age of business, GB (2010–2014)

Source: Charterhouse BBS 2010–2014.
Base: All SMEs under 2 years 2010 (5,143), 2011 (5,333), 2012 (4,886), 2013 (4,866), 2014 (3,239); all SMEs 2–5 years: 2010 (1,825), 2011 (1,979), 2012 (2,263), 2013 (2,264), 2014 (2,159); all SMEs 5–10 years: 2010 (1,051), 2011 (1,404), 2012 (1,472), 2013 (1,566), 2014 (1,593); all SMEs over 10 years: 2010 (7,760), 2011 (7,364), 2012 (7,057), 2013 (7,025), 2014 (7,061).
Notes: Charterhouse BBS records the year the SME started trading. However where this date is before 2005 this is just recorded in 5-year bands. This means, depending on the year of interview, it is not always possible to accurately identify whether an SME is 5–10 years old or over 10 years old when it began trading between 2000 and 2005. In these cases a proportion of cases have been randomly assigned to the 5–10 years or over 10 years band depending on the likelihood of being in that band. For example, for the 2013 dataset 1/5 of those who started trading between 2000 and 2004 are assigned to 5–10 years (as only those who started in 2004 would enter that band).

Figure 24: Switching rates by age of business, NI (2015)



Source: Charterhouse NI BBS 2015.
Base: Under 5 years (109), 5–10 years (103), over 10 years (588)
Note: Due to the sample size of the Charterhouse NI BBS, there are few SMEs that have been in business for less than two years. Therefore all SMEs under five years old are grouped together.

Which banks do SMEs switch to?

58. In this section, we provide more detail on switching, summarising:

(a) the proportion of overall switchers that each bank gained;

(b) the proportion of switchers relative to banks' own customer base;

(c) the proportion of net switchers that each bank gained; and

(d) the proportion of net switchers relative to banks' own customer base.

59. All the charts in this section are for GB.[34]

Proportion of overall switchers each bank has gained

60. Figure 25 shows that the largest five banks are all gaining a proportion of switchers. [✂] are gaining some switchers, although less than the five largest banks.

[34] The sample size of switchers in NI is too small to analyse.

Figure 25: Proportion of switchers gained by bank in GB (2011–2014)

[✂]

Source: Charterhouse BBS.
[✂]

Switchers as a proportion of banks' own customer base

61. Figure 26 shows that, for [✂], switchers are higher proportions of their customer base, suggesting that switching is an important factor for their BCA businesses. The four largest UK wide banks are gaining less than [✂]% of their customer base through switchers.

Figure 26: Switchers gained as a proportion of customer base in GB (2011–2014)

[✂]

Source: Charterhouse BBS.
[✂]

Proportion of net switchers each bank has gained

62. Figure 27 shows that once switching losses are accounted for, [✂] is making small switching gains whilst [✂] are losing customers through switching. [✂] made gains in 2012, but lost customers in 2014. [✂] was the largest proportionate gainer in 2014, followed by [✂].

Figure 27: Net (gained minus lost) proportion of switchers in GB (2011–2014)

[✂]

Source: Charterhouse BBS.
[✂]

Net switchers as a proportion of banks' own customer base

63. Figure 28 shows net switchers as a proportion of the bank's customer base. Consistent with the results above, [✂] have the highest proportions.

Figure 28: Net switchers as a proportion of the bank's current base in GB (2011–2014)

[✂]

Source: Charterhouse BBS.
[✂]

Comparison of switching with other industries

64. At present there are no sources that compare SME switching behaviour across different industries using a consistent sample of SMEs. However, there

are individual and separate studies that examine switching rates by SMEs in specific industries, most notably energy and communications. For example, in energy, a survey by BMG Research Ltd for Ofgem found the following.[35]

(a) Approximately, three-fifths of SMEs had switched gas/electricity suppliers in the last five years. 26% had switched once, 21% had switched twice and 13% had switched three or more times over this period.

(b) Of those that had switched energy and gas suppliers in the last five years, 39% had switched in the last year. This equated to an annual switching rate of 23% across all SMEs.

(c) Switching rates were highest for those that spent between £5,000 and £10,000 on their energy bill.

65. In the communications sector, a research report by Jigsaw for Ofcom found that approximately one-fifth (20%) of SMEs had switched their internet supplier in the last two years, 21% had switched their mobile phone and 19% had switched their land line. 47% had never switched.[36]

66. Compared with these industries, it appears that BCA switching levels are lower, but these differ from BCAs in two key respects.

67. First, gas, electricity and communications represent a larger proportion of SMEs’ overall business costs compared to BCAs:

(a) BMG Research Ltd’s research for Ofgem found that on average, businesses spent approximately £5,000 a year (including VAT) on electricity and it accounted for, on average, 16% of all operating costs. The average spend on gas was lower at around £4,000 (including VAT) and 13% of overall costs on average.

(b) Similarly, research conducted on behalf of Ofcom found that average expenditure on communications was just over £1,000 for the smallest SMEs, almost £4,000 for SMEs with ten to 49 employees and over £11,000 for the largest SMEs.

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[35] *Micro and Small Business Engagement in Energy Markets*, a research report by BMG Research Ltd prepared for Ofgem, March 2015.
[36] *SMEs experience of communication services*, a research report by Jigsaw Research prepared for Ofcom, October 2014.

(c) The average cost of a BCA, by contrast was £380 in 2014.[37]

68. Second, utilities typically have fixed-term contracts. The end of a contract was often a trigger for SMEs to search for alternative offers and switch suppliers. For example, the second most popular factor prompting SMEs to switch their energy supplier, after pursuing cost savings, was receiving a renewal notice from an existing supplier or seeing the contract end date on the bill.[38]

69. In banking there are no fixed-term contracts for BCAs. The evergreen nature of the product means that SMEs are often not prompted into considering and reviewing their banking arrangements. The end of free banking can sometimes act as a prompt to review banking, but as discussed in Section 8 the effects of this are limited to a subgroup of SMEs.

Multi-banking

70. Switching is one measure of customer engagement, but there are other indicators of customer engagement, including multi-banking. There are two different definitions of multi-banking.

(a) Narrow multi-banking, where an SME holds a BCA at more than one bank.

(b) Broad multi-banking, where an SME holds different financial products at different banks.

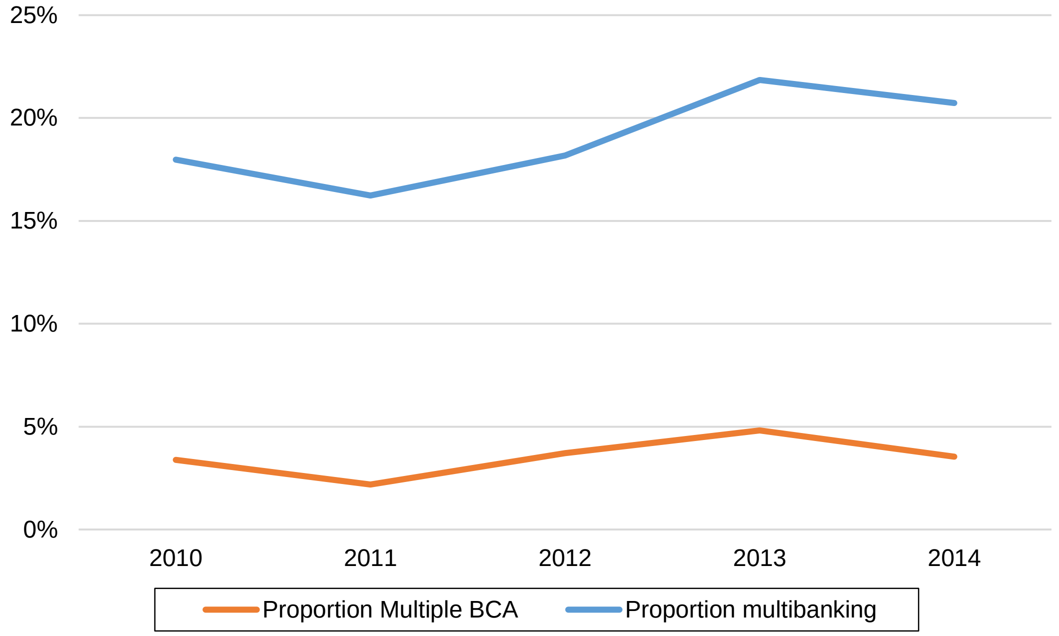
71. Figure 29 shows that whilst a substantial minority of SMEs hold products at more than one bank, the proportion that hold more than one BCA with different banks is much lower at only 3.6% in 2014. Figure 30 shows that in NI, fewer SMEs hold multiple products at different banks (12%) but there is slightly more narrow multi-banking (6%).

72. Our qualitative research also found that multiple product holdings with different providers was in some cases driven by a belief that it would be an advantage in applying for other products in the future.[39] We also noted that the larger SMEs (in GB) are more likely to be multi-banking under both definitions.[40] We consider the narrow multi-banking measure to be a more

[37] See Appendix 6.2, Table 1. This is the average revenue for a bank account excluding the net value of funds. This is equivalent to the average cost. Note that the costs may vary depending on the number of transactions and use of overdraft facilities.
[38] *Micro and Small Business Engagement in Energy Markets*, a research report by BMG Research Ltd prepared for Ofgem, March 2015.
[39] This is much lower than for PCAs, where 31% of customers hold a PCA at more than one bank. See Appendix 7.4.
[40] See Figures 31 and 34.

important indicator of potential customer engagement with respect to BCAs, whereas the broad measure is more suitable when considering the behaviour of SMEs in relation to other products.[41]

Figure 29: Proportion of SMEs multi-banking with different providers in GB (2010–2014)



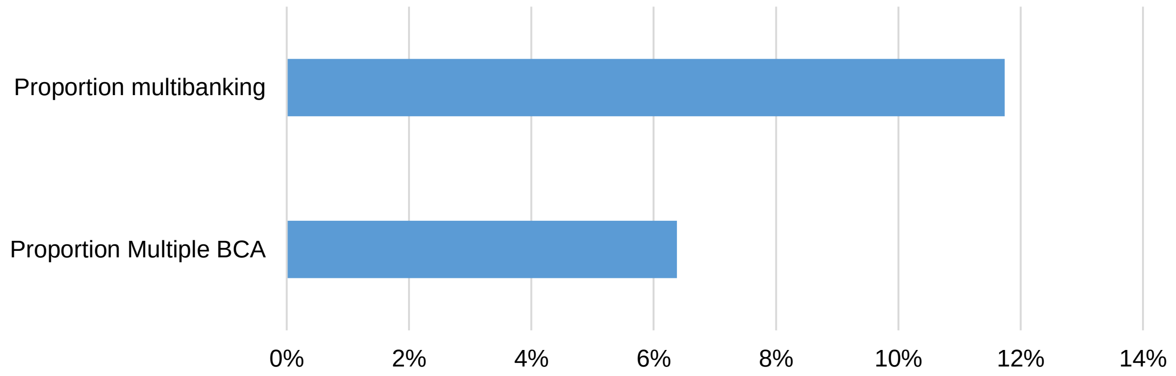
Source: Charterhouse BBS, 2010–2014.
Multiple bank base: 2010 (4,435), 2011 (4,450), 2012 (4,245), 2013 (5,015), 2014 (4,435).
Multiple BCA base: 2010 (4,210), 2011 (4,311), 2012 (4,109), 2013 (4,813), 2014 (4,847).
Note: Multi-banking products are taken to include BCAs, Overdrafts, Credit cards (and charge cards), factoring/invoice discounting, business loans, commercial mortgages, asset finance, instant access deposit account, and term deposits.

73. The level of narrow multi-banking does not suggest high levels of SME engagement in BCAs. This means that banks are unlikely to be considering this as a substantial threat from their existing customer base.

74. In NI the level of multiple BCA holding is higher than in GB, although the proportion holding another banking product with another bank is lower than in GB.

[41] We note that 82% of SMEs are using more than one banking product, although 77% hold more than one product with their own bank. The products SMEs are most likely to get from another bank is credit cards and asset finance (see Appendix 8.2, Figure 9).

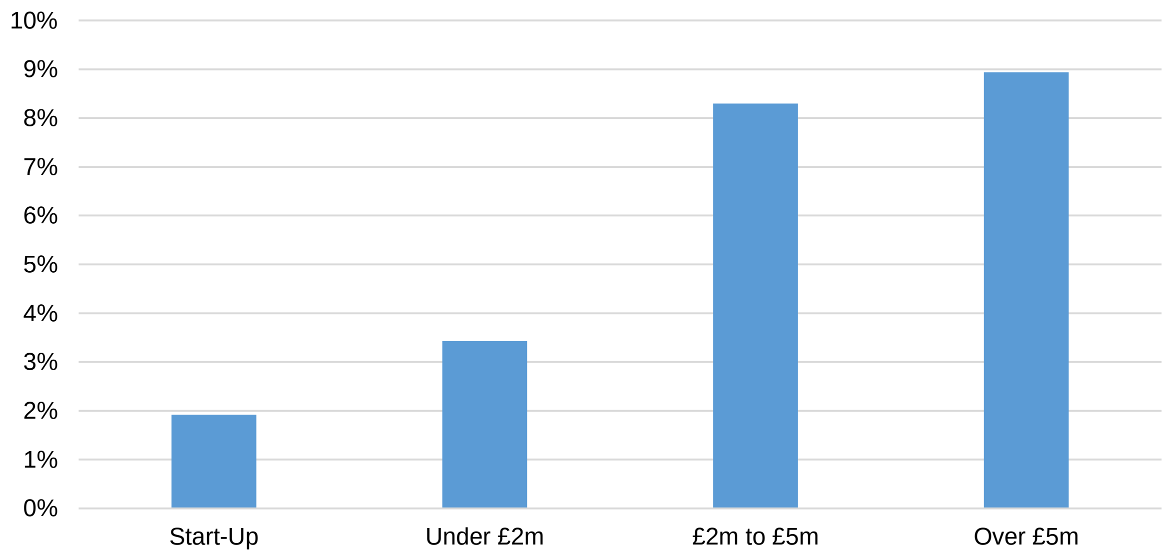
Figure 30: Proportion of SMEs multi-banking with different providers in NI (2015)



Source: Charterhouse NI BBS.
Multiple bank base: All SMEs with sterling BCAs who were asked about products they held in the last 12 months (340).
Multiple BCA base: All SMEs with sterling BCAs (716).
Note: Multi-banking products are taken to include BCAs, overdrafts, factoring/invoice discounting, business loans, commercial mortgages, asset finance, instant access deposit account, and term deposits. Therefore 'multiple products with multiple banks' is taken to mean having any of the products listed at a bank other than their main bank.

75. The level of multiple BCA holding can vary depending on the size and age of the SME. Figure 31 shows that SMEs in GB with a larger turnover are the most likely to have more than one BCA.[42,43]

Figure 31: Proportion of SMEs holding more than one BCA by turnover, GB (2014)

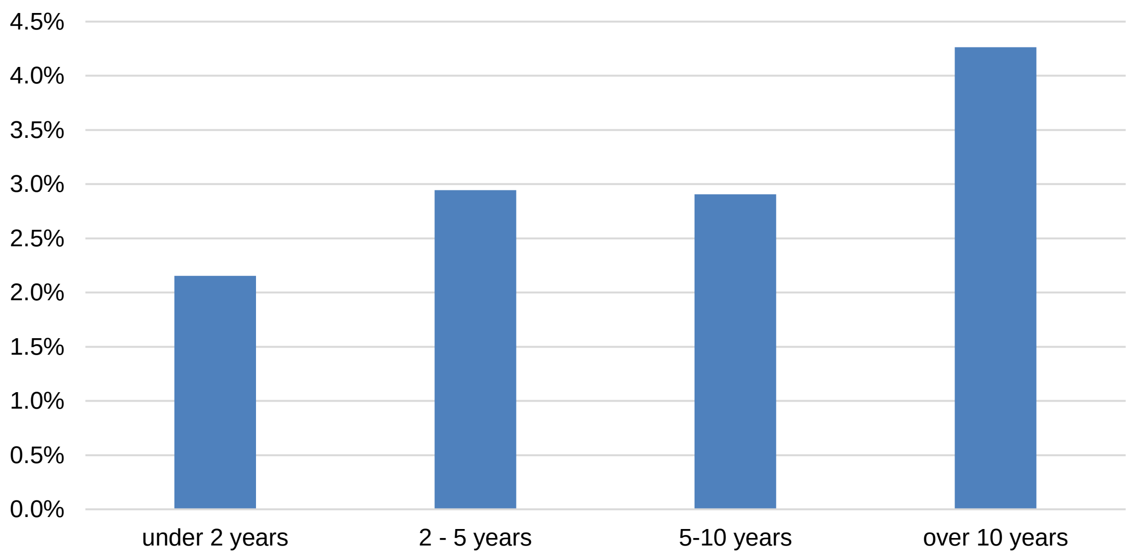


Source: Charterhouse BBS 2014.
Base: start-ups (2,920); SMEs under £2 million (8,938); SMEs £2 to £5 million (498); SMEs over £5 million (728).

76. Older businesses also had a higher level of narrow multi-banking (see Figure 32).

[42] Potentially, some of these BCAs are dormant rather than active.
[43] The HSBCG survey 2015 found 9% of SMEs surveyed have more than one BCA. It also found that the highest proportion of multi-bankers was amongst SMEs with turnover of between £500k-£2m, although SMEs with turnover above £2m were more likely to multi-bank than SMEs with turnover below £500k.

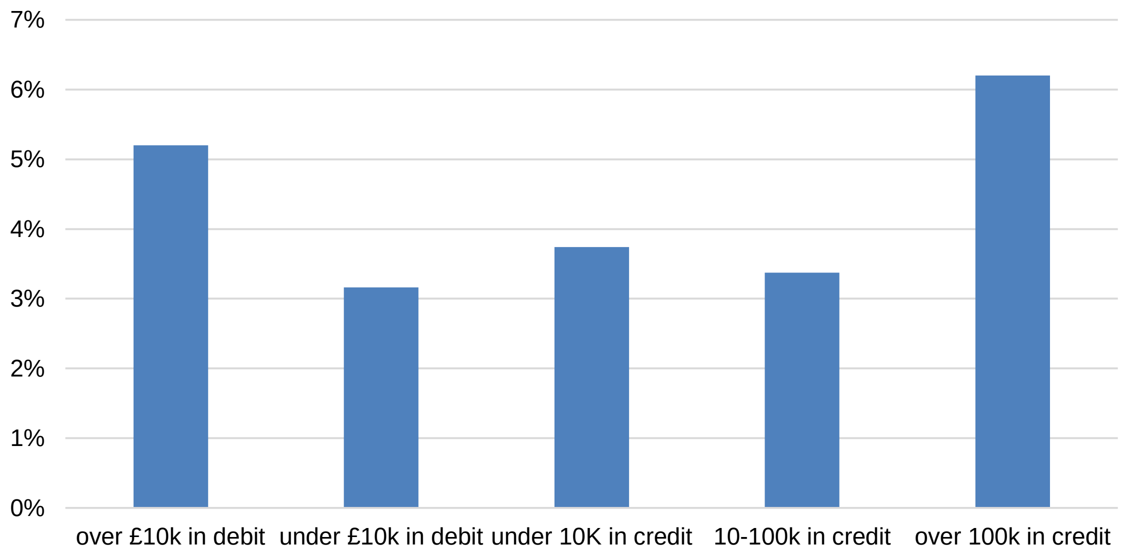
Figure 32: Proportion of SMEs holding more than one BCA by age of business, GB (2014)



Source: Charterhouse BBS 2014.
Base: SMEs under 2 years (3,239); SMEs 2–5 years (2,159); SMEs 5–10 years (1,593); SMEs over 10 years (7,061).
Notes: Charterhouse BBS records the year the SME started trading. However where this date is before 2005 this is just recorded in 5-year bands. This means, depending on the year of interview, it is not always possible to accurately identify whether an SME is 5–10 years old or over 10 years old when it began trading between 2000 and 2005. In these cases a proportion of cases have been randomly assigned to the 5–10 years or over 10 years band depending on the likelihood of being in that band. For example, for the 2013 dataset 1/5 of those who started trading between 2000 and 2004 are assigned to 5–10 years (as only those who started in 2004 would enter that band).

77. Figure 33 shows that SMEs with high-credit balances are most likely to have more than one BCA.[44]

Figure 33: Proportion of SMEs holding more than one BCA by size of balance GB, (2014)



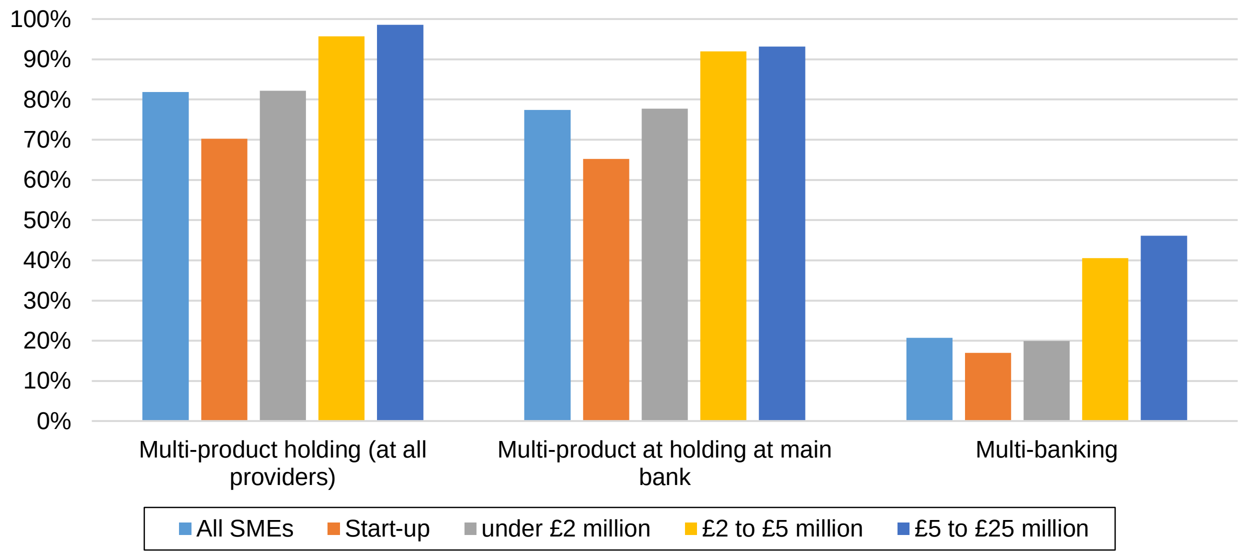
Source: Charterhouse BBS 2014.
Base: All SMEs asked about account balances (2,014): over £10k in debit (337), under £10k in debit (330), under £10k in credit (1,836), £10–100k in credit (1,168), over £100k in credit (662).

[44] The difference between those who are over £10,000 in debit (ie with a large overdraft) and those under £10,000 in debit or credit is not statistically significant.

Note: Balances are for BCAs only (including overdrafts) but do not include loans.

78. The level of broad multi-banking can depend on the size of SMEs, with larger SMEs more likely to multi-bank.

Figure 34: Proportion of SMEs holding multiple products at any bank, own bank and other banks, GB (2014)



Source: Charterhouse BBS 2014.
Base: All SMEs asked about other banking products (4,993), start-ups (608), <£2 million (3,151), <£2 to £5 million (502), over £5 million (732).

Other indicators of customer engagement

79. We noted above that BCA switching rates appeared low. However, this was not the only indication of customer engagement and not the only way in which customer behaviour could exert a competitive constraint on banks. Barclays told us that it 'considered that it was incorrect to assess switching in isolation from multi-banking and competition for customer churn'[45] whilst HSBCG told us 'the CMA has not demonstrated that the current rates of switching equate to weak competition…The CMA will also need to address the question of whether the consistently high churn rate (linked to SME business failures) is sufficient to drive competition.'

80. In this section we assess:

(a) the extent to which customers negotiate with banks, which can be a way for customers to exert a constraint on banks without switching; and

(b) the length of time with banks.

[45] Further Barclays noted that multi-sourcing, where the customer had a relationship with a UK financial provider other than a bank was also relevant.

Negotiation

81. If an SME is able to negotiate successfully with its bank to attain better terms either on a BCA or other products, this may reduce the need for an SME to consider switching, whilst still meaning a bank is having to compete to retain existing customers.[46] This may provide a reason why switching statistics understate SME engagement.

82. Responses from the largest banks indicated that negotiation for BCAs primarily take place with the largest or more complex SMEs, with only limited negotiation on periods of free banking for smaller SMEs. The exact threshold above which banks negotiate terms varies from bank to bank but in general encompasses only commercial banking customers (see Table 2 above). These businesses account for a small proportion of the SME customer base.[47]

83. Similarly, the Research Works qualitative research indicated that smaller SMEs were rarely successful in negotiations with their bank and the attitude to negotiation among this group depended very much on the personalities involved in the business.

84. Therefore, the vast majority of SMEs have limited scope to negotiate with their bank on terms for BCAs. This suggests switching statistics do not substantially underestimate engagement levels because they do not take account of negotiations between SMEs and banks over BCA pricing.[48]

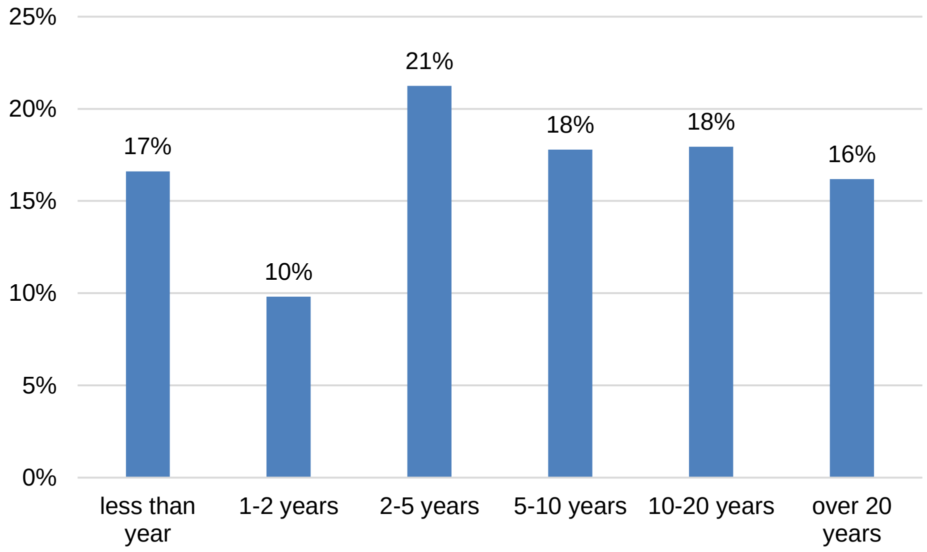
Length of time with bank

85. Another indicator of engagement is the length of time an SME has spent with its bank. If an SME has been with its bank for a long time, this may be an indicator that it is not engaged. Figure 35 shows that 34% of SMEs in GB had been with their main bank for over ten years. This compares to 46% of SMEs having been in business for at least ten years. In fact 70% of SMEs that have been in business for over ten years have been with their main bank for at least ten years, and 79% of SMEs that have been in business for at least five years have been with their main bank for at least five years.[49]

---

[46] This will only be true if the SME has a credible threat to switch.
[47] Businesses with turnover between £6.5 million and £25 million account for less than 1% of all SMEs. See business population estimates.
[48] Negotiation appears to be a more important consideration for loans.
[49] Charterhouse BBS 2014.

Figure 35: Amount of time spent with main bank, GB

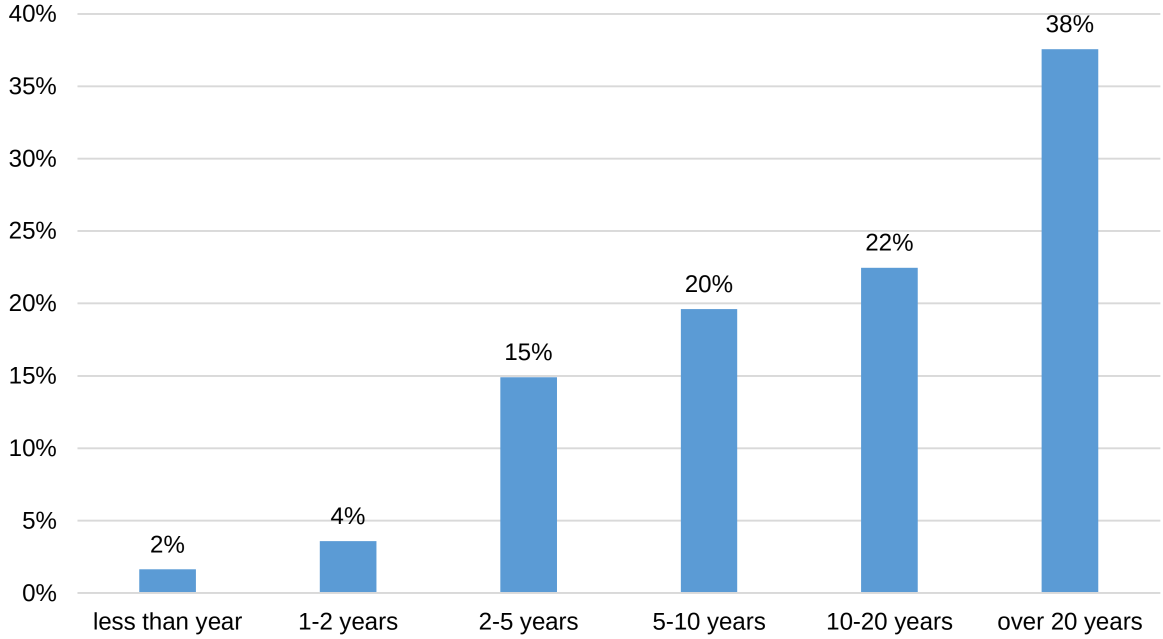


Source: Charterhouse BBS 2014.
Base: All SMEs (14,239).

86. In NI, 21% of SMEs have been with their bank for less than five years, while 60% have been with their main bank for over ten years. As noted in paragraph 18 70% of SMEs in NI have been in business for more than ten years. In NI 77% of SMEs that have been in business for over ten years have been with their main bank for at least ten years, and 88% of SMEs that have been in business for at least five years have been with their main bank for at least five years.[50]

[50] Charterhouse NI BBS.

Figure 36: Amount of time spent with main bank NI



Source: Charterhouse NI BBS.
Base: All SMEs (808).

Motivations for switching

87. In this section we explore the motivations for switching. In particular we look at the potential prompts to switching, including:

   (a) SMEs' level of satisfaction with their banks;

   (b) reasons for switching;

   (c) behaviour at the end of free banking periods; and

   (d) SMEs' attitude to banking.

Customer satisfaction

88. When SMEs are dissatisfied with the service they are receiving, one could expect a greater propensity to change provider. Data from the Charterhouse BBS suggested that satisfaction levels were around 51% for the largest four UK wide banks[51] This was slightly lower than for other banks (60%) (see Figure 38).

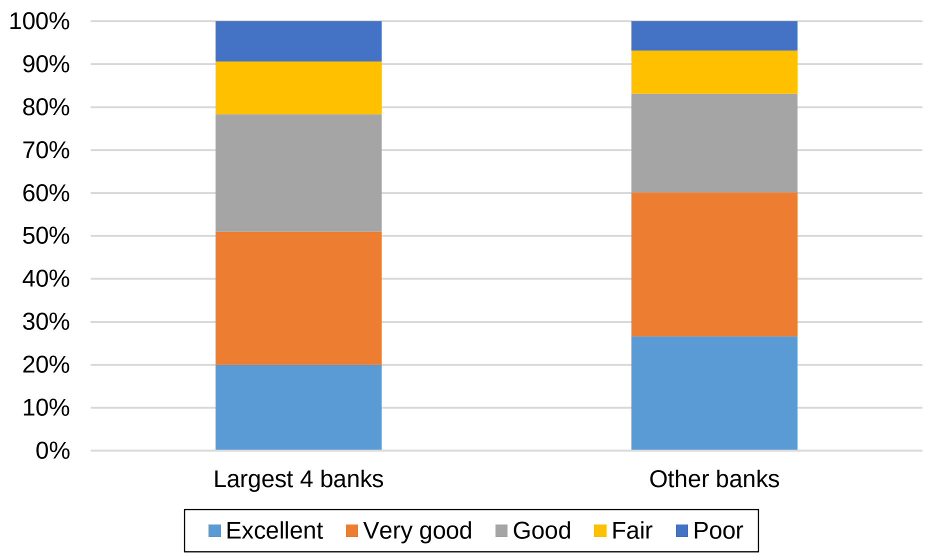
[51] This is for satisfaction levels "Excellent" and "Very good".

Figure 37: Satisfaction with main bank in GB (2014)

[✂]

Source: Charterhouse BBS 2014.
[✂]

Figure 38: Satisfaction with main bank, GB (2014)



Source: Charterhouse BBS 2014.
Base: SMEs with largest four banks (11,759), SMEs with other banks (2,480).

89. Satisfaction scores in NI are similar to those in GB, with [✂] having the highest satisfaction scores.

Figure 39: Satisfaction with main bank, NI

[✂]

Source: Charterhouse NI BBS.
[✂]

90. An alternative measure of satisfaction is the NPS. Under this measure, the four largest UK wide banks and other established banks typically have negative scores, whilst some of the [✂] have positive scores. See Figure 40 for GB results and Figure 41 for NI results.

Figure 40: NPS by bank, GB (2014)

[✂]

Source: Charterhouse BBS 2014.
[✂]

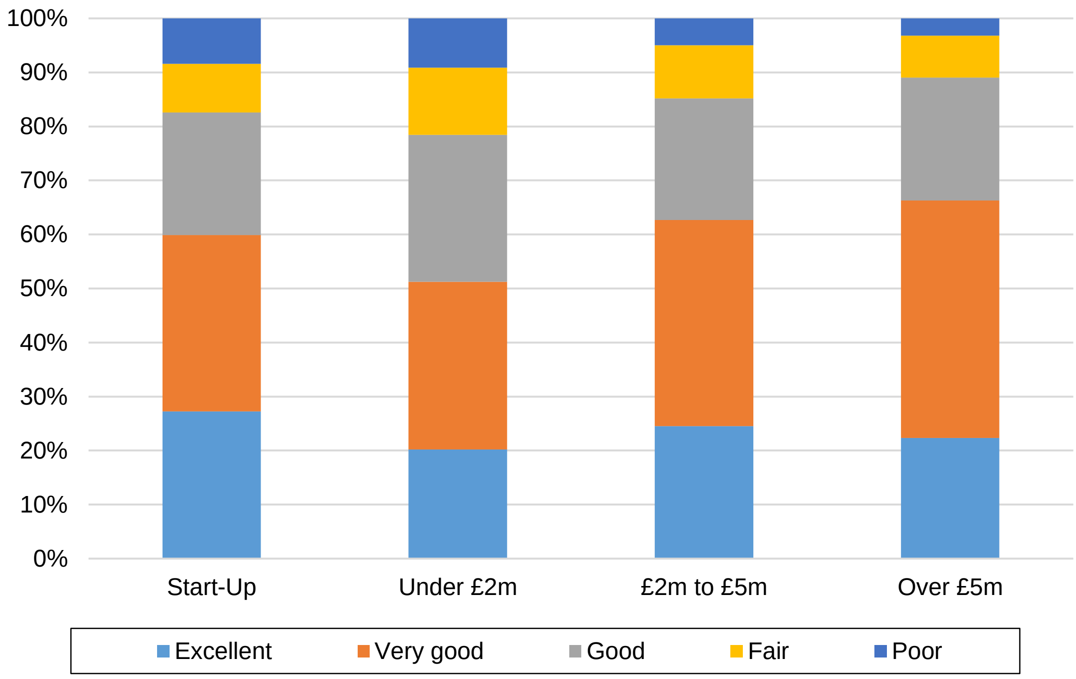
Figure 41: NPS by bank, NI

[✂]

Source: Charterhouse NI BBS.
[✂]

91. Satisfaction is lowest among SMEs with turnover under £2 million in GB (Figure 42).

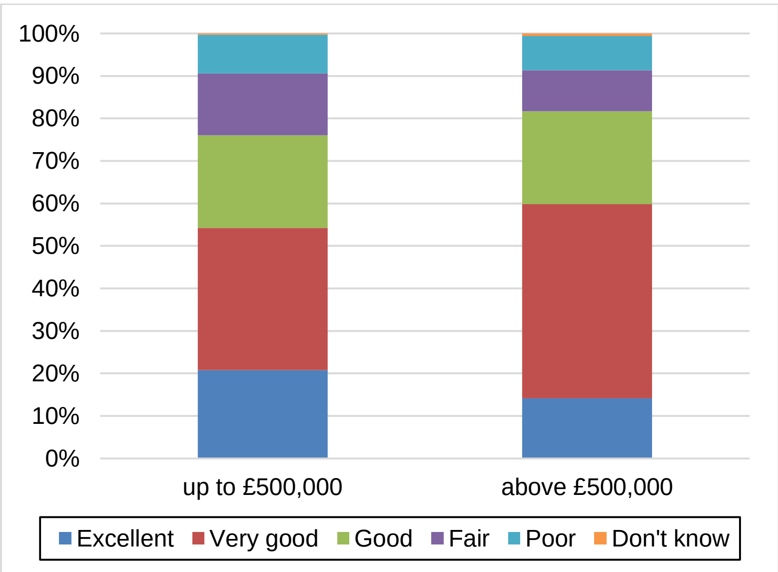
Figure 42: Satisfaction by turnover, GB (2014)



Source: Charterhouse BBS 2014.
Base: All SMEs 2014: start-ups (2,920), under £2 million (8,938), £2 to £5 million (967), over £5 million (1,414).

92. Satisfaction levels between the smaller and larger SMEs in NI are similar (see figure 43), although larger SMEs are less likely to rate their satisfaction with their main bank as "excellent."

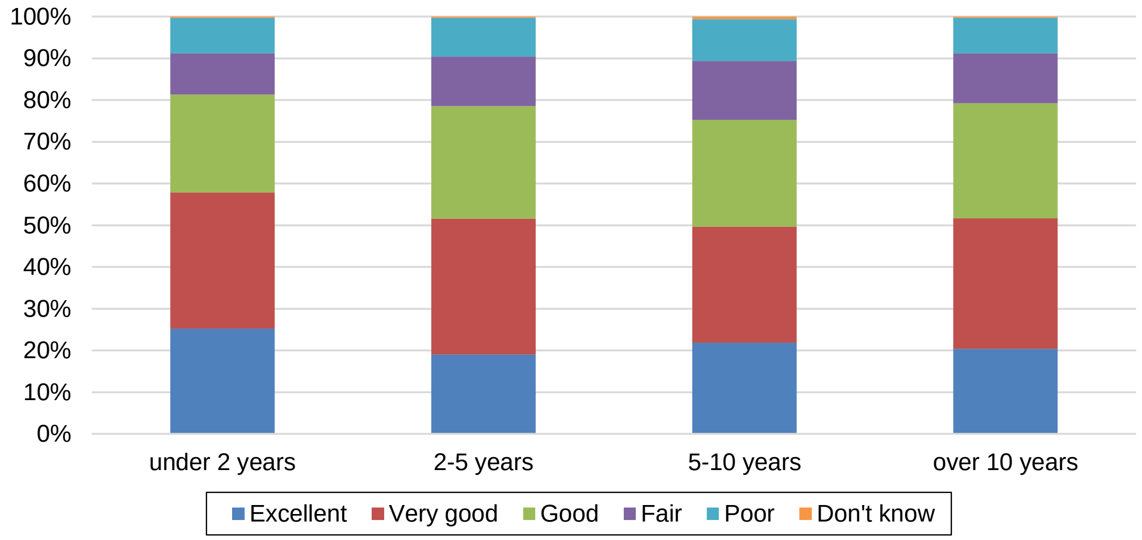
Figure 43: Satisfaction by turnover, NI



Source: Charterhouse NI BBS.
Base: All SMEs, up to £500,000 (658), above £500,000 (150).
Note: Due to the smaller sample size in NI it was only possible to make comparisons by size for SMEs over and under £500,000 turnover.

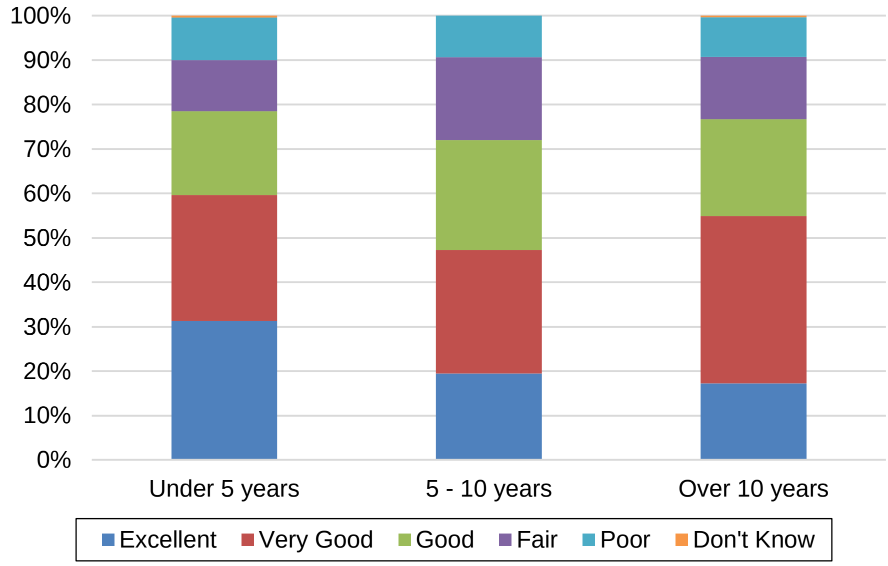
93. Figure 44 for GB shows satisfaction among SMEs over two years old is relatively similar, those under two years have slightly higher satisfaction scores.[52]

Figure 44: Satisfaction by age of business, GB (2014)



Source: Charterhouse BBS.
Base: All SMEs 2014: SMEs under 2 years (3,239), 2–5 years (2,159), 5–10 years (1,593), over 10 years (7,061).

Figure 45: Satisfaction by age of business, NI



Source: Charterhouse NI BBS.
Base: under 5 years (109), 5–10 years (103), over 10 years (588)
Note: Due to the sample size of the Charterhouse NI BBS, there are few SMEs that have been in business for less than two years. Therefore all SMEs under five years old are grouped together.

[52] The HSBCG survey 2015 found that 9% of SMEs were dissatisfied with their bank, with a third of those not considering switching. These results are consistent with the Charterhouse BBS findings. HSBC also found larger and older SMEs were more likely to be very satisfied with their bank. The turnover findings are consistent with Charterhouse, although Charterhouse finds businesses under two years are the most satisfied.

94. The FCA CASS qualitative research[53] found that SMEs that were not considering switching were 'Happy with existing provider.' However, it noted that:

> [i]n the majority of cases this perceived 'happiness', could perhaps be more accurately be described as a passive level of satisfaction. When prompted, *non-considerers* typically specified two key factors, which correlated with the reasons for inertia…:
>
> *(a)* They saw their provider as reliable as they had never had any problems with them, so their account was low maintenance. In addition they tended to be have grown used to their provider's services (whether branch or online), as they often had a long-term 'relationship' with them
>
> *(b)* …relatively few 'moments of truth' where a provider can drive a more active level of satisfaction. These tended to differ by audience, but involved instances of a provider 'being there when needed', such as … offering lending to support *business* cash flow[54]

95. Elsewhere in the report, it noted the views of both microbusinesses and SMEs that were non-considerers. It found the following:

> *(a)* Micro business non-considerers tended to be much more negative about their banking relationship than their consumer counterparts. This appears to be driven by a sense that banks aren't particularly interested in meeting the needs of smaller businesses. Reasons for this included a perceived lack of flexibility in supporting businesses with cash flow and lending solutions, as well as a sense that the relationship management which was formerly offered, was being gradually eroded.[55]
>
> *(b)* SME non-considerers tended not to reference as many of the problems [with their banking relationship as were] identified by smaller businesses. Whilst distance of their relationship with their bank was [mentioned] this was not always seen in

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[53] Optimisa Research, *Engagement with current accounts and the switching process*. This research covered consumers, micro-businesses, SMEs and charities.
[54] Optimisa Research, *Engagement with current accounts and the switching process*, p31.
[55] ibid, p20.

negative terms. In part this was because generally SMEs tended to feel a little more in control […] and were more likely to feel they were receiving the necessary financial support.[56]

96. This research therefore provides a mixed picture of SME satisfaction levels, with some SMEs not necessarily satisfied with their banking relationship and feeling that their bank did not care about them. This aligns with the FSB survey, which found that 56% considered that banks didn't care about small businesses.[57]

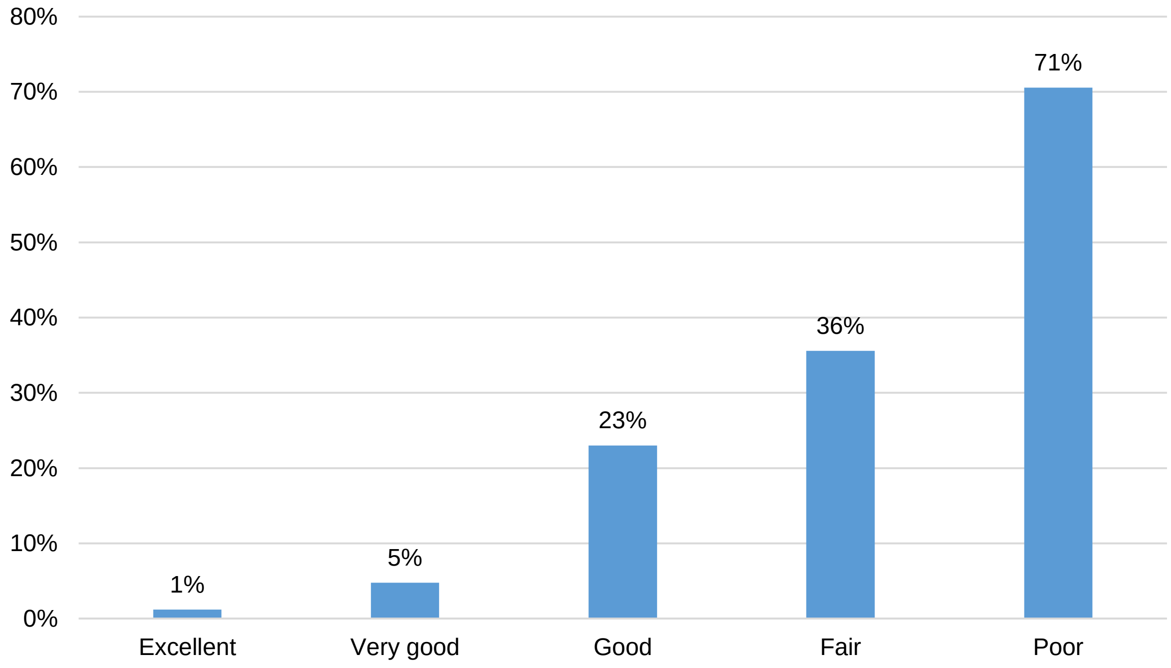
97. Research conducted on behalf of the Payments Council found that businesses that had neither switched nor considered switching were most satisfied with their banking services. Those that had considered switching but had not switched were least satisfied with their BCA.[58] 76% of non-considerers had not switched because they were satisfied with their current provider whereas only 7% of considerers gave the same reason for not switching.[59]

98. The HSBCG survey 2014 also noted that 44% of non-considerers did not switch because they were satisfied with their existing service while 21% said they valued their existing relationship and were concerned that [a] new [relationship] would not be as good.[60] HSBCG found that "the existence of a significant group of SME customers whose propensity to switch is low because they are satisfied with the service they receive and value their relationship with their existing provider."

99. Similar to GB, SMEs that were least satisfied with their bank were most inclined to consider switching in NI.[61]

[56] ibid, p21.
[57] FSB survey, slide 17.
[58] Payments Council research, p20. Note that this research excludes businesses with turnover greater than £1.8 million or more than nine employees (ie it is focused on microbusinesses that are eligible for CASS).
[59] Payments Council research, p27.
[60] HSBCG survey 2014.
[61] This analysis for GB can be found in Section 8.

Figure 46: Rates of switching consideration by satisfaction level, NI



Source: Charterhouse NI BBS.
Base: All SMEs; Excellent (145), Very Good (288), Good (189), Fair (109), Poor (75).

Switching triggers including push and pull factors

100. When SMEs need to make regular active decisions over which provider to use, there can be many natural points (or triggers) for customers to consider which provider is most suitable. For example, in the context of insurance products, annual contracts with renewal letters can act as a trigger for customers to consider whether they want to continue using their current provider or to switch to another provider.

101. However, for SMEs using BCAs, the evergreen nature of the product means there are few natural trigger points. The Research Works study found that switching is often prompted by dissatisfaction with some aspect of the current provider's offering although it identified four potential trigger points. These are:

(a) when moving from PCA to BCA;

(b) at the end of the free banking period;

(c) when the business reaches a particular stage of growth or requires different banking support (such as a need to borrow); and

(d) if the relationship with the bank is perceived to have broken down.

102. The latter trigger points are less regular and may not occur for all SMEs. We note that dissatisfaction appears low although the rate of SMEs considering

switching increases as satisfaction decreases.[62] When SMEs are motivated to switch, this can be either because they became frustrated with their previous provider (‘push’ factors) or because they were enticed by the offering of a new provider (‘pull’ factors).

103. In this section we summarise the evidence on which push and pull factors are important in leading to SMEs to switch and whether it is push, pull or a combination that leads SMEs to change provider.

Which push and pull factors are important?

104. In the Charterhouse BBS, switchers were asked ‘What was it about your former bank that encouraged you to move away from them as your main bank?’ and ‘… what was it about your main bank that made you choose them as your new main bank?’. The results are set out in the charts below.

Figure 47: Top 10 push factors, GB (2010–2014)

[✄]

Source: Charterhouse BBS.
[✄]

Figure 48: Top 10 pull factors, GB (2010–2014)

[✄]

Source: Charterhouse BBS.
[✄]

105. From Figure 47 we see that [✄] are the most important push factors. The [✄] has been decreasing over time. The importance of [✄], whilst small, appears to be increasing over time as a push factor. The [✄] factor has been declining over time, but it is unclear what may be driving this.

106. From Figure 48 we see that [✄] are the two most important pull factors. In addition, [✄] appears to be an important pull factor. [✄] is less important as a pull factor. However the reason for this may be the high degree of SMEs already using their PCA provider for their BCA so they are then not able to switch to their PCA provider for their BCA.

107. We also assessed whether the push and pull factors differed by SME turnover and age.

[62] However, a third of dissatisfied SMEs do not consider switching. In addition, not all SMEs that consider switching go on to switch providers.

Figure 49: Top 10 push factors for SMEs by turnover, GB – All years combined (2010–2014)

[✂]

Source: Charterhouse BBS 2010–2014.
[✂]

Figure 50: Top 10 pull factors for SMEs by turnover, GB – All years combined (2010–2014)

[✂]

Source: Charterhouse BBS.
[✂]

108. Figure 49 sets out the push factors for businesses of different sizes. Among push factors, [✂] appeared to be the most important across all sizes of business. However, we note [✂] did not appear to be an important push factor for larger businesses. [✂] were more important for this group. [✂] appeared to be less important as turnover increases.

109. Figure 50 shows that for businesses with a turnover of less than £2 million, [✂] appears to be an important pull factor, notably more than for the other sizes of business. [✂] are not important pull factors for businesses with a turnover over £5 million.

110. We also assessed whether push and pull factors varied depending on the age of the business. Figure 51 shows that businesses between two and five years old are most likely to cite [✂] as a push factor, whereas [✂] was more important for businesses over ten years old, compared to other businesses.

Figure 51: Top 10 push factors for SME by age of business, GB (2014)

[✂]

Source: Charterhouse BBS.
[✂]

Figure 52: Top 10 pull factors for SME by age of business, GB (2014)

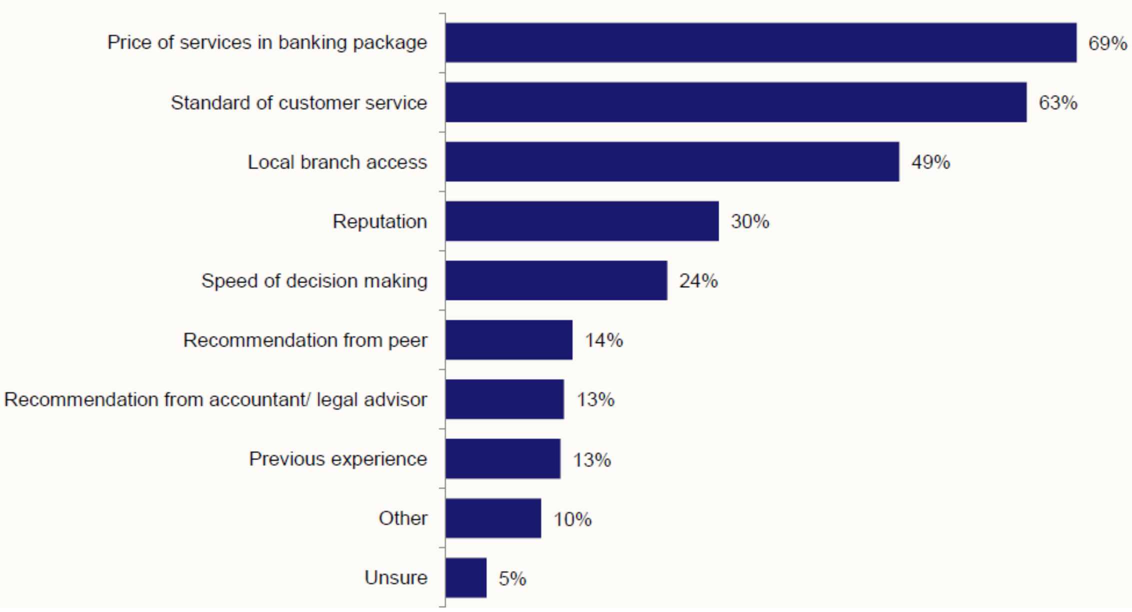
[✂]

Source: Charterhouse BBS.
[✂]

111. With respect to push factors, Figure 52 shows that the [✂] was more important for businesses between two and five years old. [✂] appeared to be a more important pull factor for newer businesses than older businesses.

112. Among FSB members, pricing was the most important consideration when switching accounts.[63] This was followed by customer service and local brand access (see Figure 53).

Figure 53: Considerations when switching accounts



Source: FSB.

113. HSBCG told us that "market research studies suggest that […] SME customers of different sizes attach different levels of importance to certain "push factors" and "pull factors" (for example, free banking is typically a more important "push factor" and "pull factor" for smaller SME customers, while customer service is typically a more important "push factor" and "pull factor" for larger SME customers)."

114. The HSBCG survey 2014 found that for those customers who moved their account, free banking was by far the most important rationale/incentive. Cheaper charges are also important, ranked third. Convenient branch ranks highly (second). However, this is entirely driven by single-employee SMEs, and as such is more likely to be reflective of local branch demand rather than regional or national branch demand.[64]

115. The HSBCG survey 2015 found that the key aspects of service an SME wanted to know more about from a new bank was price (69% of three most important mentions), digital offering (50%) and branch location (43%).[65]

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[63] FSB survey, slide 6.
[64] HSBCG survey 2014.
[65] HSBCG survey 2015.

116. For both non-switchers and considerers, 67% and 62% respectively considered that having a good relationship with their bank was more important than cheaper fees. Amongst switchers, however, only 46% agreed, suggesting that there may be differences to what drives switchers and non-switchers[66].

Push, pull or both?

117. The research above outlines the importance of particular push factors or particular pull factors. Below we set out evidence about whether push factors, pull factors, or a combination of those are responsible for switching behaviour.

118. A number of different sources of evidence suggested that push factors were predominant in switching decisions.

(a) The FCA's qualitative consumer research found that the reasons to switch cited by switchers and considerers tended to be dominated by 'push' factors.[67] Pull factors tended to play more of a secondary role and customers often suggested that there was little differentiation across providers and/or relatively limited incentives on offer. [68] The initial triggers were often further underpinned by underlying motivations such as dissatisfaction with the product and service levels.[69]

(b) [✂] conducted exit interviews to understand the reasons why its business customers (turnover up to £5 million) switched. In July 2012 it found that for 41% of customers it was due to the push factors including charges being too high and a poor relationship with the business manager. For 18% of customers it was due to pull factors, including free banking. For 32% of customers it was due to a combination of the push and pull factors. It also noted that 'In many switching decisions, "push" factors arise first. This leads to consideration of other providers and an awareness of the "pull" factors such as free banking.'

(c) For larger SMEs,[70] [✂] noted that 'As customers move up the SME turnover range, they become even more likely to be multi-banked. Correspondingly, it is less common for a bank to lose its entire relationship with an existing customer. Customers may move their main banking relationship but often retain products with their existing bank.' It

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[66] ibid.
[67] Push factors include (1) banking errors, (2) branch closures, (3) end of free banking, and (4) unwillingness to support/lend to the business. Optimisa Research, *Engagement with current accounts and the switching process*.
[68] Pull factors include (1) incentives (like free banking), (2) better interest/lending rates, (3) better international banking rates, and (4) ethical lending policy (more important for charities).
[69] Optimisa Research, *Engagement with current accounts and the switching process*, pp24 & 25.
[70] Those with turnover between £5 million and £25 million.

considered that ‘It is more common that 'push' rather than 'pull' factors cause a SME with turnover of £5-25 million to move. It is often an accumulation of poor service rather than one specific issue that results in a customer moving. Relevant 'push' factors could include a change in their relationship director, or a poor relationship in overall terms.’

(d) LBG told us that ‘key switching triggers are generally linked to push factors (perceived failures on the part of LBG) rather than pull factors (incentives provided by competitors). The research concluded that smaller businesses (with annual turnover under £500,000), typically cited high bank charges and/or convenience factors e.g. closure of local branches as reasons to switch. These factors were compounded by the lack of perceived service received in return for their payments. Larger business (with annual turnover over £500,000) were more likely to have more complex issues and cited the lack of service, flexibility and understanding as reasons for switching. Concerns were most typically associated with managing growth, short-term cashflow issues and/or longer term financial difficulties.’[71]

(e) LBG’s research also noted that ‘Often underlying reasons for dissatisfaction with LBG, which on their own don’t trigger to switch, but as they build up serve to reinforce motivations to move.’ In addition it noted ‘Failure to meet basic banking needs were a major trigger to move – bank charges were key for smaller businesses, whereas larger SMEs focussed more on the service provided.’

(f) The HSBCG survey 2015 found the most common reasons cited for SMEs to consider making a change to their business bank in the last five years was dissatisfaction/bank error (33%) and the SME coming to the end of free banking (20%).[72]

(g) Qualitative research conducted by Charterhouse and submitted by LBG, mentions ‘[t]he decision to switch was a push from their existing bank rather than a proactive decision based on pull factors from the new banks.’[73]

---

[71] LBG noted that this was qualitative research conducted in 2013 involving interviews with 27 customers who had switched away from LBG. LBG also told us that in general, when a customer decided to switch provider, both push and pull factors were likely to be relevant to some extent and the relevant importance of different drivers of switching behaviour would differ, and that it was unaware of any analysis that attempted to quantify the relative importance of these different drivers in a robust manner.
[72] HSBCG survey 2015.
[73] This research analysed the rationale for switching for SMEs with turnover of up to £1 million.

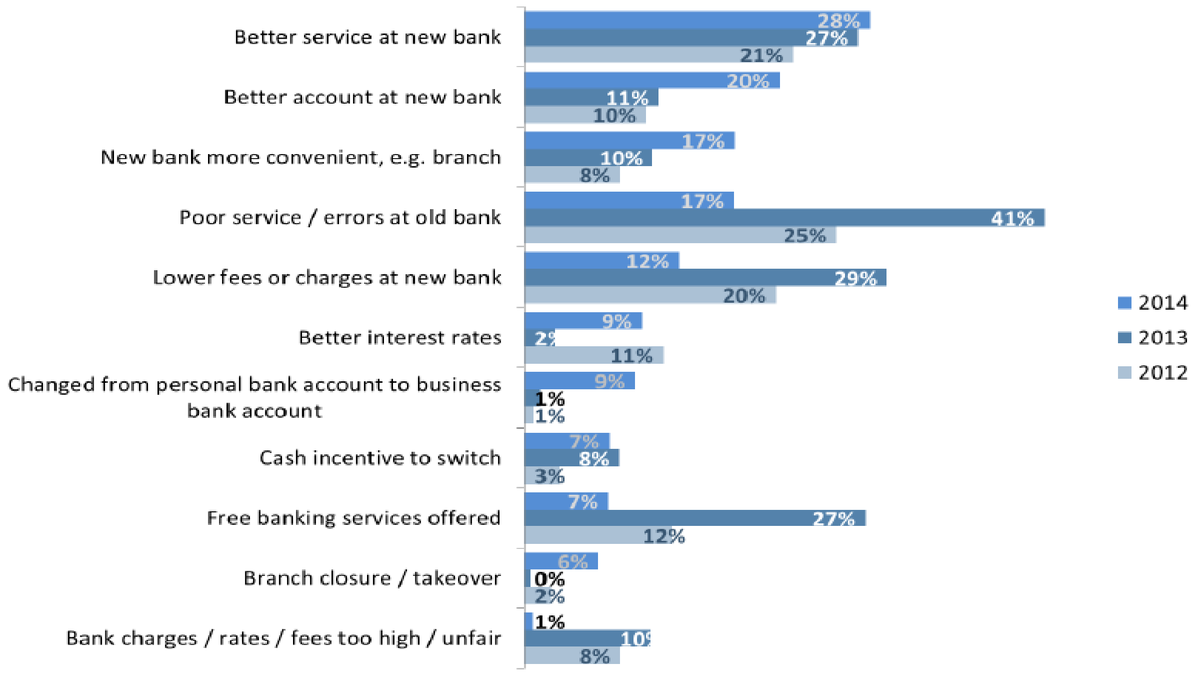
(h) Metro and Handelsbanken both mentioned poor service as reasons that customers left their old banks.

(i) TSB's initial research suggested that being forced to move (relevant for Lloyds/TSB split) was the main push factor. Access to branches and having a PCA with the provider were cited as the main reasons for their choice of (new) BCA provider.

119. However, other research noted a more mixed picture of drivers for switching, with push factors only being a little more prevalent than pull factors. For instance:

(a) A Payments Council survey suggested that for most years, pull factors were predominant over push factors (see Figure 54). However, in 2013, 41% of respondents claimed that poor service or errors at their old bank led them to switch accounts.[74]

Figure 54: Reasons for switching accounts



Source: Payments Council.
Base: All businesses that have switched accounts in the past 12 months.

(b) Research conducted on behalf of Santander noted that 'service and relationship tends to push businesses, whilst firmer attributes such as rates and international capabilities pull businesses; switching tends to be a combination of push and pull factors.' They also noted that 'When asked

[74] Note that sample size is likely to be small as switching rates were around 2% and for a sample of 1,000, that would equate to around 20 respondents. This would help to explain the high variability in the results.

about reasons to switch business bank, those who have not switched in the past tend to overstate the role of most push factors, and emphasise different ones. Those who have switched before tend to have a more focused view of factors that played a role in their decision.'

Behaviour at the end of free banking

120. The research outlined above shows that the end of free banking can act as a trigger for businesses to switch banks in search of a better deal or extended free banking period. This is consistent with the information received from parties, which showed higher account closures in the period running up to the end of free banking and in the subsequent periods just after the free banking period.[75] For example:

(a) HSBCG stated that "for both start-up and switcher businesses which received a period of free banking, there were clear points through the customer lifecycle at which we can observe peaks in customer attrition, above and beyond the typical portfolio attrition rates:

(i) For start-ups, [✄]

Figure 55: HSBCG analysis of attrition rates for start-ups over time

[✄]

Source: HSBCG.

(ii) For switchers, [✄].

(b) LBG, similarly, found evidence of higher account closures around the end of free banking periods.

(c) [✄] told us that account closures increased notably in the month before free banking ended. In addition, dormancy rates among continuing accounts increased from around [✄]% to more than [✄]% six months after the end of free banking which could indicate they were switching to a competitor. It also noted that this increase may also reflect normal business closure, however it was unable to identify from the data those accounts that were switching and those that resulted from normal business closure.

[75] We note that account closures can be due to businesses exiting/closing down, rather than just switching.

(d) However, another piece of [✂] research tracked exits and switcher rates of start-ups and SMEs that had switched to [✂]. It found that for both these groups switching rose around the end of the free banking period.

SMEs' attitude to banking

121. SMEs' attitude to banking could affect their willingness to engage with the product. FCA CASS qualitative research explored what inhibited SMEs from switching BCAs and the extent to which this related to the switching process. The research included SMEs, microbusinesses, charities and consumers.

122. Four common themes emerged from the research which helped to explain a relative lack of SME engagement in the provision of BCAs.[76]

(a) Low maintenance – A reliable current account service was often taken for granted, as generally there were relatively few examples of SMEs having problems with their accounts, even if there was a high volume of both incoming and outgoing payments.

(b) Low costs – It was recognised that BCAs were an essential product, but they were generally not perceived to be a big cost burden on customers. In contrast to other products or services which were switched more regularly (eg insurance or energy), the lack of a clear price anchor meant that switching BCAs did not offer an obvious way to make cost savings.

(c) Long term – The majority of non-considerers had been with their existing bank for a number of years, with some having only ever had one banking provider. This could lead to entrenched behaviour as SMEs stuck to what they knew. In addition some SMEs felt they may receive beneficial treatment for being a long-term customer, as their existing bank/building society would know their history, eg their ability to keep up with payments. This sentiment was particularly pronounced among businesses with long-standing relationships with relationship managers.

(d) Convenience – Linked to the often long-standing relationships which customers had with their existing providers was the sense that they were comfortable with their existing banking services. Longevity meant that SMEs grew used to the way they managed their accounts through their existing banks' services, whether their preferred channel was online, telephone or the branch. Local branches could be particularly important

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[76] Optimisa Research, *Engagement with current accounts and the switching process*, pp17 & 18.

for businesses or charity organisations that regularly needed to pay cash or cheques into their accounts.

123. LBG research also noted that perceived barriers to switching were relatively high so it was a big decision to move bank. It also mentioned inertia, hassle and risk as barriers to SME switching.[77] Switching appeared to happen around certain ‘moments of truth’ where businesses had more advanced needs such as lending. LBG’s research on customer retention noted that it was push factors that triggered switching. This was either when businesses’ circumstances change or there was a failure to meet either a basic or advanced business need.

124. The FCA CASS qualitative research noted that SMEs did not think other providers would be any different.[78] This barrier was often identified as part of a wider distrust in the banking industry and was more evident among smaller businesses that felt they were ‘just a number’ to the big banks.[79]

Barriers to switching

125. The HSBCG survey 2015 found that the most common reason for SMEs who were considering switching deciding not to switch was SMEs not wanting to lose the benefits of their current relationship (80%). Problems with the switching process (51%) and problems finding out information about other banks (48%) also featured.[80]

126. For those who did not consider switching, 89% did not want to lose existing benefits, 77% considered there to be a lack of incentives, whilst fewer considered the switching process (39%) or lack of information (36%) to be barriers to switching.[81]

127. In this section we consider:

(a) the practical steps an SME needs to undertake to switch banks;

(b) SMEs’ confidence in the switching process; and

(c) the ease of the switching process.

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[77] The research did also note however that changing circumstances reduced the barriers to switching as [they] often forced the customer to rethink their finances or open new accounts anyway.
[78] Optimisa Research, *Engagement with current accounts and the switching process.*
[79] Optimisa Research, *Engagement with current accounts and the switching process*, p32.
[80] HSBCG survey 2015.
[81] HSBCG survey 2015.

Practical steps of the switching process and the length of time to switch

128. SMEs seeking to switch BCA need to go through a number of processes before they are able to switch banks. First they must choose a new bank to switch to and then open a new account with that bank. This includes filling in all the necessary paperwork and providing the relevant documentation. They must also organise for their balances and payments details to be transferred to their new bank. SMEs can either do this manually or use CASS.

129. FCA CASS qualitative research showed that SMEs often confused the account opening process with the switching process. For SMEs the account opening process can be onerous. This is in part due to AML regulations (described in more detail in Section 3 and Appendix 3.1, and discussed further in Section 10 and Appendix 10.1). The information required will vary according to the potential AML risk the customer poses and will be higher for SMEs trading internationally.

130. For example, LBG told us that the complexity of the application process and the length of time taken to open a bank account was in large part determined by the need to comply with increasingly onerous mandatory regulatory requirements such as AML regulations and the time taken by applicants (and where relevant their professional advisers) to provide the required information. Data collected from banks shows that while smaller SMEs were often able to open their accounts within 48 hours, ten days or more was not uncommon and this could extend to months in complicated cases.

Confidence in switching process

131. Payments Council research, shown in Table 5, found that among non-switchers, 57% thought the process would be easy and 52% considered it would be quick. However, they were less confident that the process would be error free.[82]

Table 5: Non-switchers: attitudes towards switching

			%
	2012	*2013*	*2014*
I think it would be easy to switch banks	54	56	57
I think it would be quick to switch banks	46	48	52
I think there would be very little work or effort involved on my part	46	47	50
I think our organisation would be in control of the process	54	61	57
I think the process would be error free	33	38	41

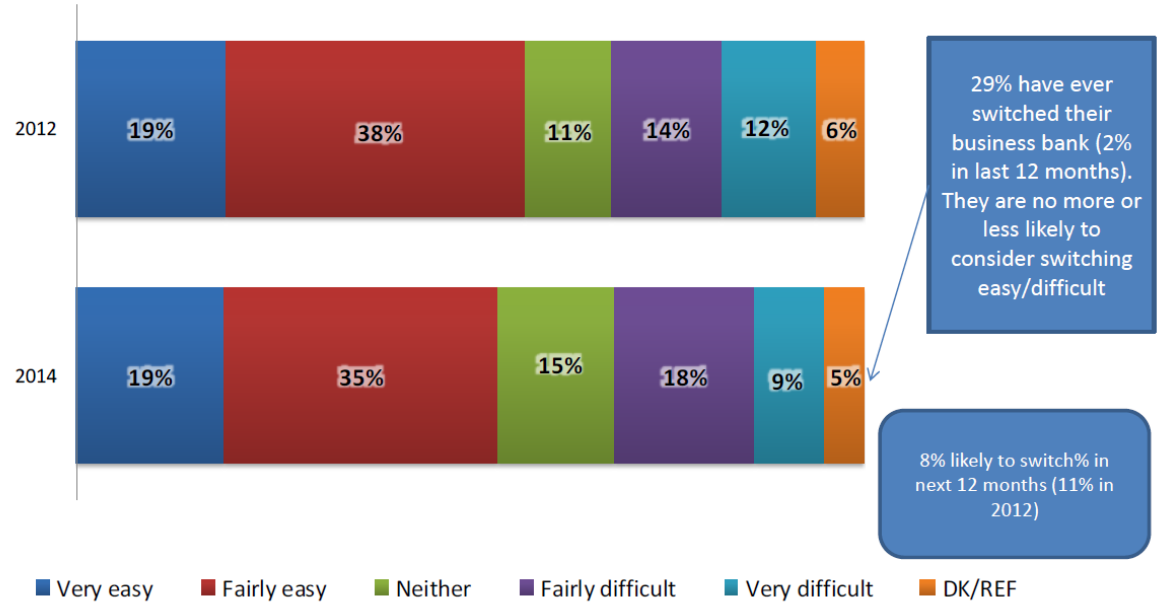
Source: Payments Council.

[82] Payments Council survey, p31.

Base: All businesses that had not switched accounts in the past 12 months.

132. Research from the BBB showed that 54% of customers perceived that it would be easy to move banks, with 27% considering it would be difficult.

Figure 56: Perceptions of how easy/difficult it is to move to a different bank (2012, 2014)



Source: BBB/BMG (2014), 'SME Journey Towards Raising Finance' survey, p45.
Note: DK means 'don't know', and REF, 'refused'

133. Whilst some SMEs considered the switching process to be easy, there was a group of SMEs which perceived that the switching process could be a difficult process and would take time. There were particular worries about incoming payments going missing, which would have an impact on the running of the business. As noted above, CASS awareness was low. The HSBCG survey 2014 considered there was some evidence that those who did not know about CASS, or thought it applied to PCAs only, would be more likely to consider switching if they knew CASS applied.[83]

Ease of switching process

134. There were three pieces of research that discussed the ease of switching.

(a) The HSBCG survey 2014 found that a significant number of switchers thought switching was a 'high effort' process with 33% of switchers regarding the process as 'high effort', even though 87% of them stated the process went 'well' for them.[84]

[83] HSBCG survey 2014.
[84] HSBCG survey 2014.

(b) In the FSB survey, 73% found the switching process easy.[85] For those who did have issues with the switching process, many of the responses were focused upon the pace of the process, the inability to speak to the right staff, the lack of clarity of what was required, and the onerous paperwork.[86]

(c) Payments Council research found that 17% of recent switchers had experienced problems during the switching process, which was an increase on 2013 (10%) but higher than 2012, when a third of businesses experienced problems during their switch. The most common problem experienced was errors with DDs and SOs, which was higher (11%) compared to the 4% of switchers in 2013, but still down from 19% in 2012.[87]

135. FCA CASS qualitative research indicated a number of areas where there were potential concerns.

(a) Payments (incoming and outgoing) going missing – This concern was particularly acute for larger SMEs and charities and incoming payments. These problems could affect short-term cash flow and/or result in failures to deliver products or services to customers, which could affect future sales.

(b) Informing customers - If businesses (and charities) needed to inform their customers and donors of the changes, this was felt to add a lot of inconvenience to the process.

(c) Charges being incurred – Whilst they considered that any charges wrongly incurred would be reimbursed, this added to the hassle factor of switching.

(d) Changing SOs and DDs – There was often an expectation that this might be something that the banks could switch automatically but lack of knowledge about the process meant it remained a concern for some.

(e) Length of time the process takes – The time the switch would take emerged as a secondary concern for the majority, the more important thing being to get it right.

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[85] FSB survey, slide 7.
[86] FSB survey, slide 8.
[87] Payments Council research, p23.

136. 21% of SMEs between two and five years old considered it would be too much hassle to switch banks after the end of free banking and 7% said it would take too long.[88]

137. The HSBCG survey 2014 found that 53% of considerers and 28% of non-considerers identified the switching process as a reason for not switching accounts. This included the process being too much hassle and the process taking too much time.[89,90]

138. Payments Council research found that among non-switchers, 57% thought the process would be easy and 52% considered it would be quick. However, they were less confident that the process would be error free.[91] Research from the BBB showed that 54% of customers perceived that it would be easy to move banks with 27% considering it would be difficult.

139. The HSBCG survey 2014 considered there was some evidence that those who did not know about CASS, or thought it applied to PCAs only, would be more likely to consider switching if they knew CASS applied.[92]

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[88] SME follow-up surveys, p29.
[89] HSBCG survey 2014.
[90] This finding is in contrast to the FCA CASS qualitative research findings. The HSBCG survey 2014 is focused on non-considerers and is quantitative. The qualitative study may have explored these views in more depth and found the length of time to be less of an issue once fully considered.
[91] Payments Council survey, p31.
[92] HSBCG survey 2014.

Further information about lending

Introduction

1. This appendix provides supporting evidence for Section 8, specifically in relation to lending. It covers the following topics:

   - Sources of evidence.
   - Why SMEs may need finance.
   - Profile of SMEs who use credit facilities.
   - Trends in SME lending.
   - Types of finance available and use.

Sources of evidence

2. We use the Charterhouse BBS to produce statistics on the use of finance products by SMEs. We have also analysed the SME Finance Monitor to obtain estimates on the proportion of SMEs that use finance. We note that the SME Finance Monitor includes SMEs that use PCAs for their business, but is weighted to be representative of the population of all SMEs by size, where size is defined by the number of employees.

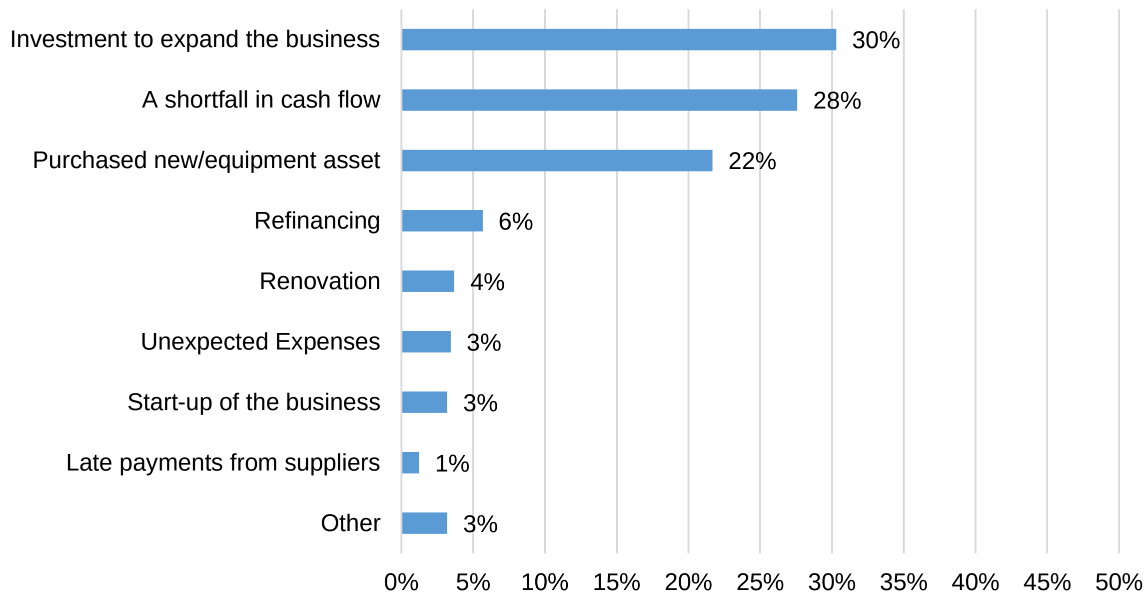
3. The Charterhouse BBS is representative of the population of SMEs with BCAs by size, where size is measured as annual turnover. While both number of employees and annual turnover are measures of SME size, they lead to quite different SME profiles. The SME Finance Monitor therefore has a much larger proportion of very small businesses (particularly sole traders), with some not using SME banking products. This means that the Charterhouse BBS reports higher proportions of SMEs holding finance than the SME Finance Monitor. Further, the SME Finance Monitor measures the flow of financial products by asking SMEs what they currently use whilst the Charterhouse BBS asks about any product held in the last year (whether or not SMEs are currently using it.)

4. In general, where both the Charterhouse BBS and SME Finance Monitor could be used for a statistic, we report results from the Charterhouse BBS (covering GB). Where possible we also report figures from the Charterhouse NI BBS. Results reported from the SME Finance Monitor and the Charterhouse follow-up surveys include NI.

Why SMEs may need finance

5. There are a number of reasons why SMEs may need finance. This includes lending for immediate expansion of the business, an investment in future expansion, a shortfall in cash flow, late payments from customers, or an unexpected cost. Figure 1 shows that the most common reasons for seeking finance were for investment to expand the business, purchasing new equipment or shortfalls in cash flow.

Figure 1: What prompted business to seek finance (UK)



Source: Charterhouse follow-up survey 1 (applying for finance), Question B1.
Base: All (406).

6. As noted in Section 4 on market definition some finance products will be suitable for a range of purposes and equally some needs may be appropriately met by a number of specific products. However, there are some differences between lending products that may mean only certain products are suitable for a particular need. For example, as noted in Section 4:

- The choice of finance may depend on whether the need is short term to manage working capital and day-to-day cash flows, or longer term for investing in business development, acquisition of property or other business assets.

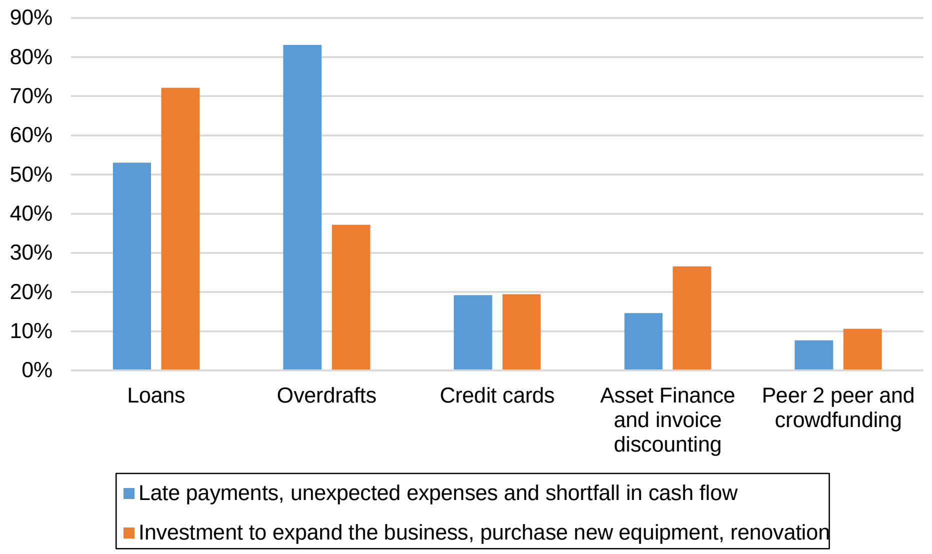
- The availability of external finance and the urgency with which it is required will also influence the decision to obtain a specific type of loan as certain types of finance take longer to put in place.

7. When applying for a general purpose business loan, security may be required. Security is not only applicable to some loans, but may also be required on overdrafts.[1]

8. Security may affect the price of the loan; where more security is held against the loan, the interest rate will typically be lower. While security may affect the decision to lend to SMEs, the lender will still need to assess the risk of the SME's ability to make repayments.

9. Figure 2 shows that SMEs consider different forms of finance, depending on their needs. In particular, overdrafts may be more suitable for cash flow issues while loans and asset finance may be more suitable for investment and business expansion.

Figure 2: Type of finance considered by need (UK)



Source: Charterhouse follow-up survey 1 (applying for finance),
Base: All (406).

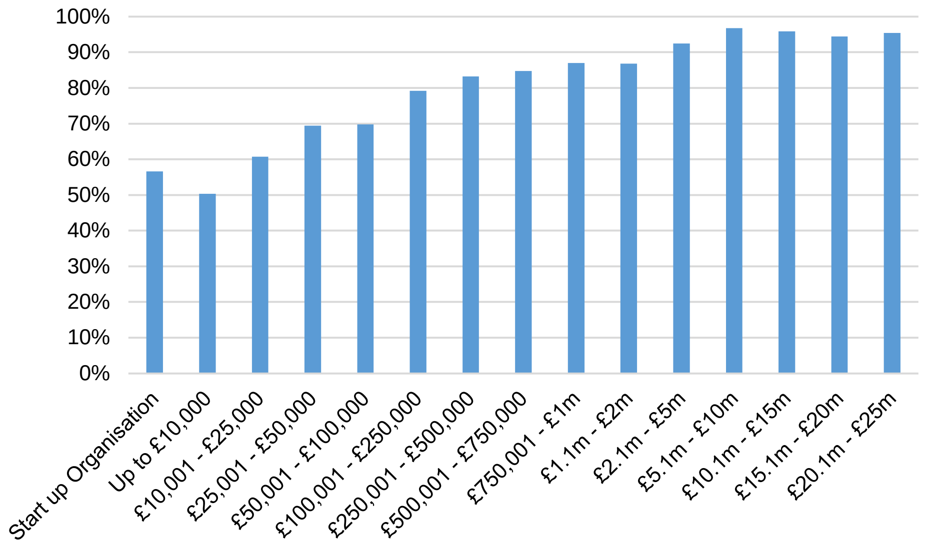
Profile of SMEs that use credit facilities

10. Lending facilities are not used by all SMEs. Some SMEs do not require finance, others are cautious of debt, and others are more suitable for (or would prefer to) finance via other means (such as personal equity). This is covered in more detail in paragraphs 15 and 16.

11. The Charterhouse BBS reveals that larger SMEs are more likely to take out lending (see Figure 3 below).

[1] The SME Finance Monitor (Q2 2015) suggests 35% of all overdrafts granted to SMEs required security, p186.

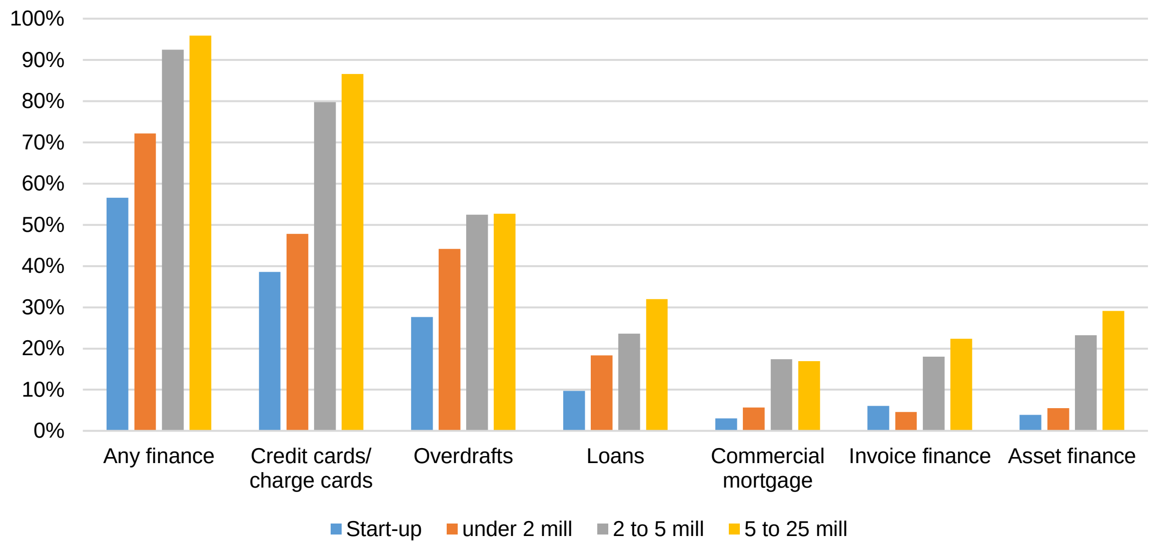
Figure 3: Proportion of SMEs that held finance in last 12 months by SME turnover (GB)



Source: Charterhouse BBS 2014.
Base: All SMEs asked about banking products other than their BCA.

12. Credit cards and overdrafts account for the greatest proportion of lending (48% of SMEs had credit cards[2] and 43% held overdrafts), while only 18% of SMEs held a loan in the last 12 months. Few SMEs use invoice finance or asset finance, and those that do are predominately larger SMEs. Figure 4 shows the proportion of SMEs in GB that take out finance products broken down by the size of SME.

Figure 4: Proportion of SMEs taking out finance (GB)



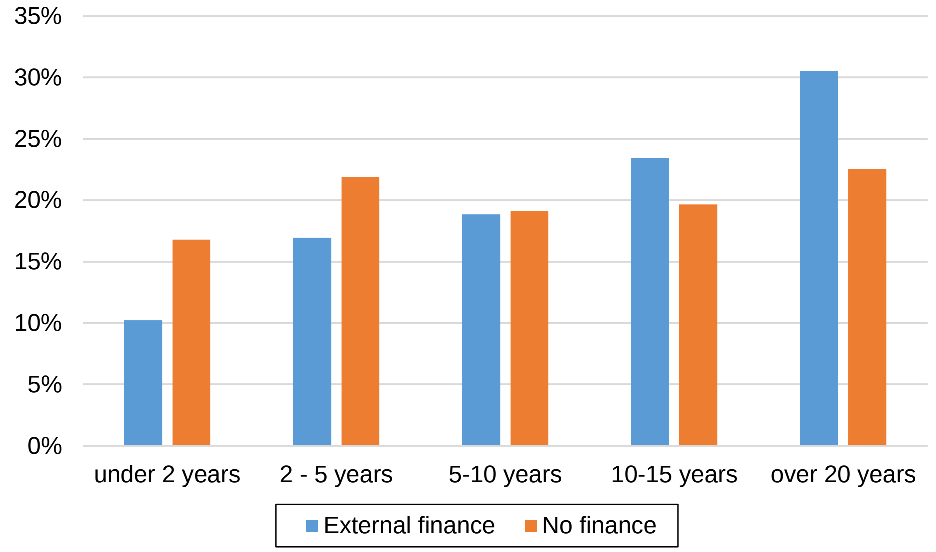
Source: Charterhouse BBS 2014.
Base: All SMEs asked about banking products other than their BCA: start-ups (608), under £2 million (3,151), £2 million to £5 million (502), over £5 million (732).

[2] Including charge cards.

13. Over 90% of SMEs with an annual turnover greater than £2 million take out some lending facility, compared with just over half of start-ups. However for start-ups, the majority of lending products taken are credit cards (and charge cards) and overdrafts, with very few taking out other types of finance.

14. Figure 5 shows that the age profile of SMEs that take out finance is skewed towards longer established businesses.

Figure 5: Age profile of SMEs that take out finance (GB)



Source: Charterhouse BBS 2014.
Base: All SMEs asked about banking products other than their BCA: under 2 years (717), 2 to 5 years (576), 5 to 10 years (785), 10 to 15 years (1,089), over 20 years (1,758).

Trends in SME lending

Use of non-bank finance

15. While banks offer different types of debt finance some SMEs may have a wider selection of ways to fund their business. Some SMEs may not generate any revenue in the near term, with a strategy of becoming profitable at some point in the future. These SMEs may not be suitable for debt finance as this relies on being able to make repayments with the income the business generates over a period of time. Where an SME expects future, rather than current profitability, it may instead consider equity finance, selling off a stake in the business for immediate credit. As noted in Section 4, it is unlikely that equity finance would be a substitute for debt finance for many SMEs.

16. There are also other options for some SMEs needing finance. For example, they may consider using personal funds to grow the business and/or take out a personal loan to invest in the business. However, such arrangements are

more like equity finance and some banks may also have formal restrictions on the use of a personal loan for business purposes.[3]

17. The SME Finance Monitor reports that in Q2 2015 approximately 36% of all SMEs that were using a lending facility (in the form of a loan, an overdraft or a credit card) had it in their personal name rather than the business. However, the use of personal loans was considerably more prevalent among sole traders, those that were using a PCA for business use and those SMEs that had worse risk ratings.[4]

18. The SME Finance Monitor also reports that 26% of SMEs had used some personal injection of finance in the last 12 months to Q2 2015 (having fallen from 40% in 2013),[5] while just 2% used equity from third parties.[6]

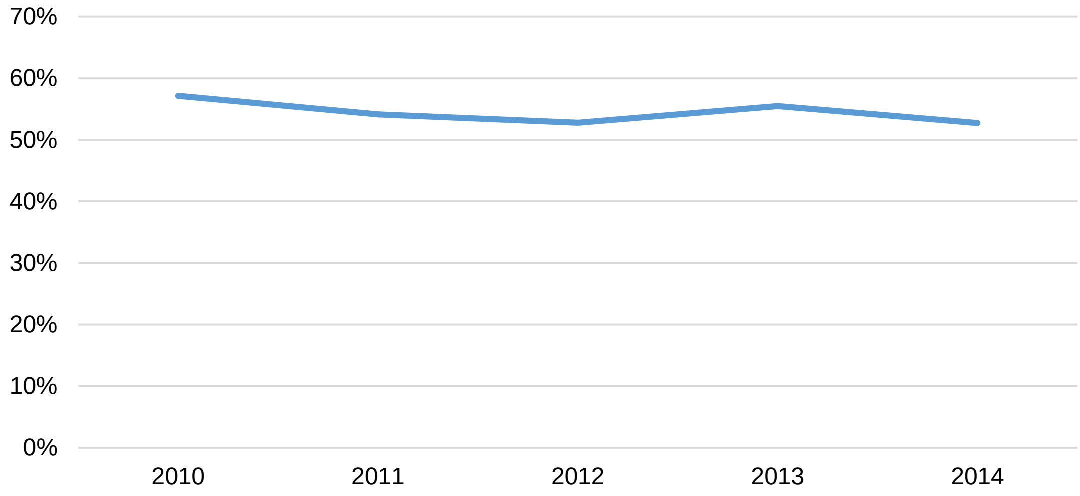
Use of bank finance

19. The financial crisis affected the amount of lending that banks issued to SMEs. Since the financial crisis, the volume of lending has been low and remained so.[7] This fall has been due to a combination of supply- and demand-side factors, including banks deleveraging (after the financial crisis), low appetite by SMEs to borrow due to the economic climate and low confidence in obtaining external finance from banks.[8]

20. As noted in paragraph 2, both the SME Finance Monitor and the Charterhouse BBS record the usage of SME lending products. Both surveys suggest that the use of external finance has remained constant over the last few years,[9] however we report Charterhouse BBS results in Figure 6 for the reasons discussed in paragraphs 2 to 4.

[3] [✂]
[4] BDRC (2015), SME Finance Monitor, Q4 2014, pp53 & 54. BDRC (2015), SME Finance Monitor Q2 2015, pp58 & 59.
[5] BDRC (2015), SME Finance Monitor, Q2 2015, p66.
[6] BDRC (2015), SME Finance Monitor, Q2 2015, p62.
[7] LBG submitted that while there had been a year-on-year net industry decline of 3%, LBG had increased its lending by 5%.
[8] BDRC SME Finance Monitor – see paragraph 22.
[9] Both surveys were established a few years since the start of the financial crisis so do not capture an earlier fall in lending to a more stable level.

Figure 6: Proportion of SMEs holding any external finance in last 12-month period, excluding credit cards (GB)

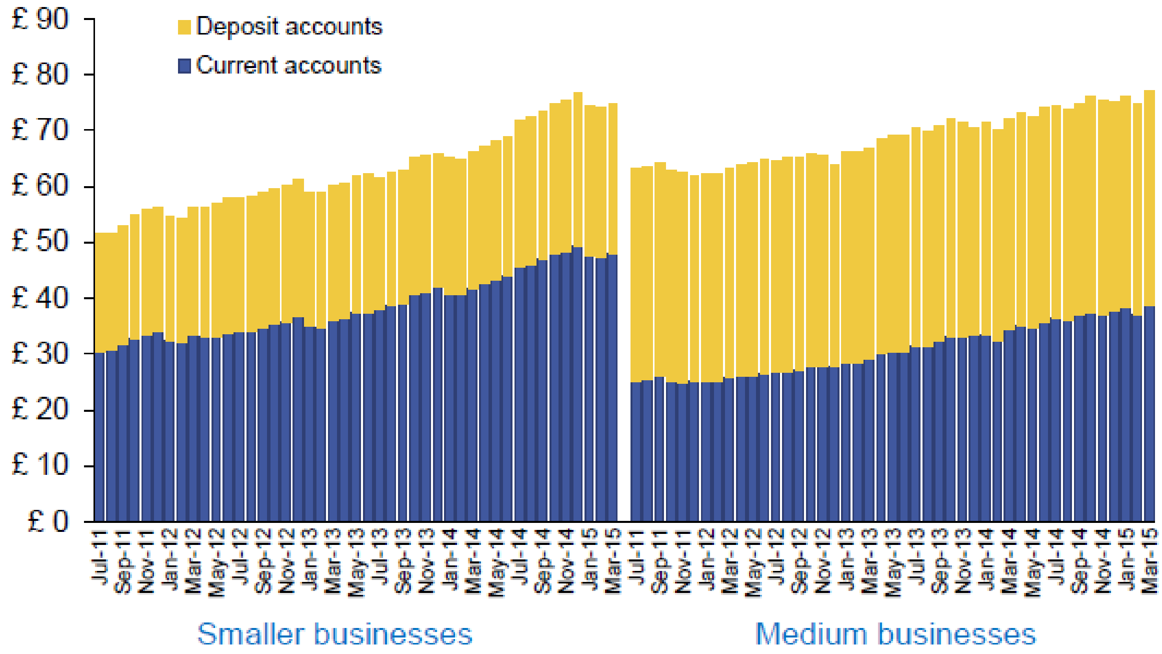


Source: Charterhouse BBS 2010 to 2014.
Base: All SMEs asked about other products: 2010 (4,412), 2011 (4,450), 2012 (4,239), 2013 (5,015), 2014 (4,993).
Note: Credit cards are excluded from this chart.

21. Figure 7, from the British Bankers' Association's statistics on bank support for SMEs, shows that many SMEs have been building their cash balances during this time, despite the low BoE base rate. At the end of Q1 2015, cash held by SMEs in current and deposit accounts totalled £151.6 billion, a 10% increase in balances from March 2014.[10]

[10] British Bankers' Association (2015), *Statistics, Bank support for SMEs – 1st Quarter 2015*, p2.

Figure 7: Deposits held (balances outstanding £bn)



Source: British Bankers' Association statistics, Statistics, Bank support for SMEs – 1st Quarter 2015, Fig 5.[11]

22. However, there is disparity between SMEs' confidence in banks' willingness to lend, and actual lending approval rates. According to the SME Finance Monitor in Q2 of 2015 69% of loans and 84% of overdrafts were approved (both the highest approval rates since 2012) while SMEs' confidence that they would be approved was much lower at 49%.[12] The SME Finance Monitor also found that this reluctance to borrow was in part down to discouragement and the hassle of the borrowing process or cost.[13]

Use and reasons for going to main bank for finance

23. Figure 8 shows, across time, the proportion of SMEs that use their own bank for a particular product rather than a different lender.[14]

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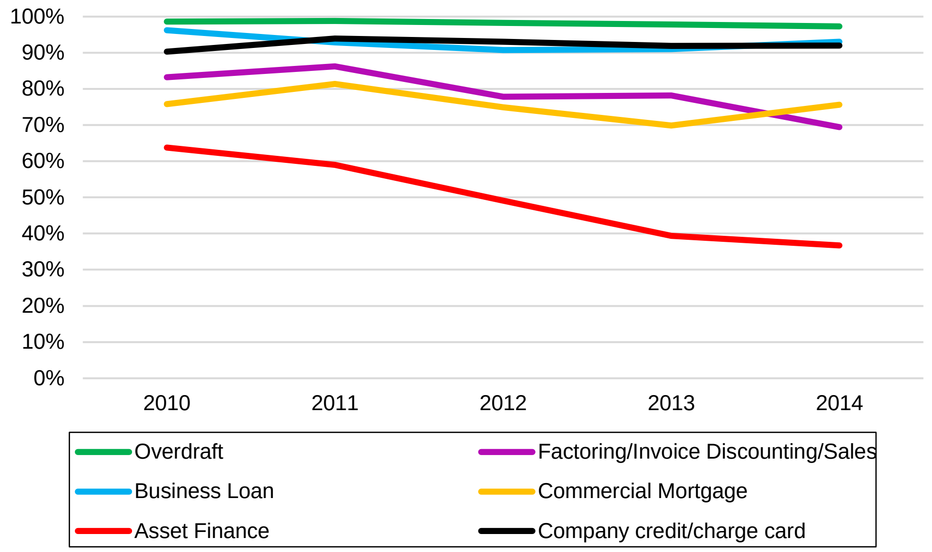
[11] The report can be downloaded from the British Bankers' Association's website.
[12] BDRC (2015), SME Finance Monitor, Q2 2015, pp146, 163 & 264.
[13] BDRC (2015), SME Finance Monitor, Q2 2015, p221.
[14] These results for NI in 2015 are shown in Section 8.

Figure 8: Proportion of respondents saying they used their main bank for each product (GB)



Source: Charterhouse BBS 2010–2014.
Base: All SMEs asked about banking products other than their BCA: overdraft: 2014 (2,219), 2013 (2,207), 2012 (1,950), 2011 (1,899), 2010 (1,888); factoring/Invoice discounting: 2014 (469), 2013 (447), 2012 (398), 2011 (384), 2010 (355); business loan: 2014 (1,062), 2013 (1,034), 2012 (990), 2011 (845), 2010 (799); commercial mortgage: 2014 (461), 2013 (432), 2012 (409), 2011 (355), 2010 (364); asset finance: 2014 (633), 2013 (689), 2012 (539), 2011 (553), 2010 (490); company credit/charge card: 2014 (2,802), 2013 (2,820), 2012 (2,178), 2011 (2,218), 2010 (3,962).

24. When comparing individual banks there is a little variation.

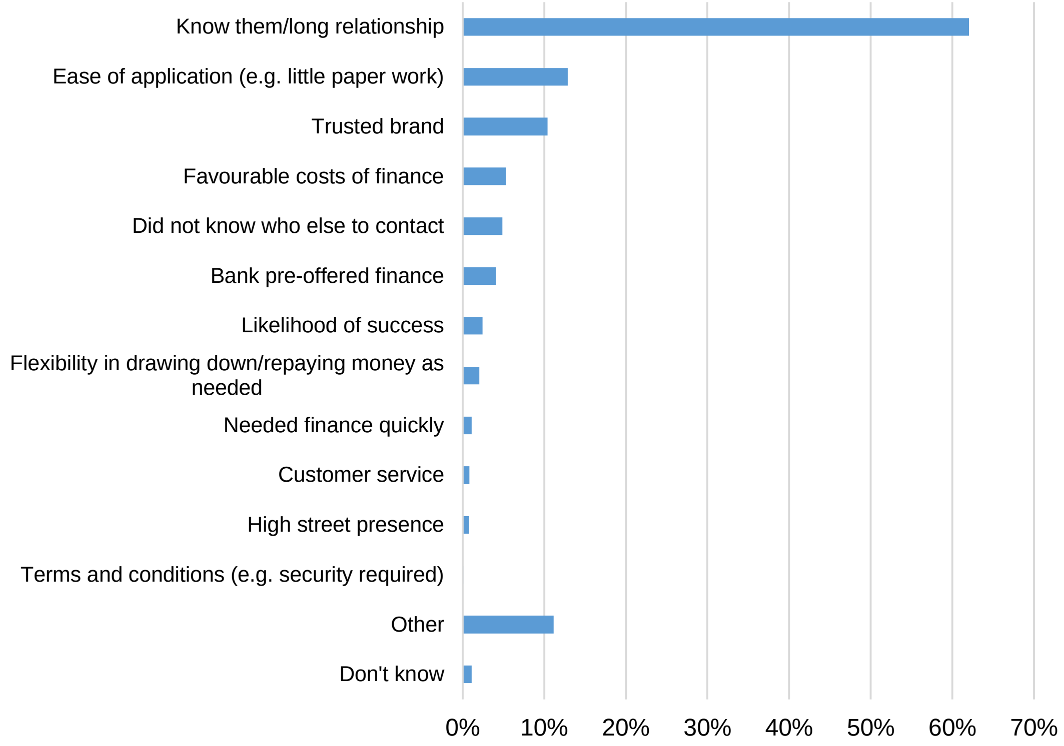
Figure 9: Proportion of SMEs that took out lending product with their main bank (of all that hold lending product) (GB)

[✂]

Source: Charterhouse BBS 2014.
[✂]

25. The British Business Bank/BMG Journey Toward Raising Finance survey asked SMEs why they went straight to their bank without considering other banks. As shown in Figure 10, relationship with their bank and ease of application were the most common reasons given.

Figure 10: Reasons why SMEs went straight to their main bank (GB)



Source: British Business Bank/ BMG Journey Toward Raising Finance 2014, A16a.
Base: All that went directly to main bank (164).

Use of alternative finance

26. Evidence from the challenger banks roundtable and a report by Nesta and the University of Cambridge on understanding alternative finance, suggests that smaller alternative lenders filled gaps in lending when the banks reduced their lending (eg these may have led to a rise in invoice finance, asset finance, peer-to-peer and trade finance). For instance, 33% of those who used peer-to-peer lending and invoice trading said it was unlikely that they would have obtained bank finance, while 79% of peer-to-peer borrowers said they had attempted to obtain a bank loan, with 22% having been successful.[15] Several banks have arrangements with alternative finance lenders. For instance Santander operates a customer signposting arrangement with Funding Circle and RBS/NatWest have reported forming arrangements with alternative lenders where they refer certain customers which do not meet their lending criteria.

[15] Nesta and the University of Cambridge (2014), *Understanding alternative finance: The UK Alternative Finance Industry Report 2014*, p31.

Types of finance available to SMEs and use

27. SMEs have access to a range of different types of debt finance.[16] As noted in paragraph 6, typically, different types of finance are designed to serve specific business needs and may differ in various aspects, such as the loan term, type of security required, interest rates and repayment methods. Below we discuss some of the different types of finance available to SMEs in more detail.

General purpose business loans (including commercial mortgages)

28. General purpose business loans are lending products whereby a bank lends a specific amount of money to an SME, with the requirement that it is repaid over a fixed time period. The repayment amounts will vary with the size and period of the loan and the applicable interest rate. The main purpose of a business loan is to help SMEs to invest and grow their businesses and is, therefore, more suited to meet medium- or long-term financial needs. General purpose business loans can either be secured or unsecured and are a major source of lending for many SMEs.

29. A commercial mortgage is a form of a business loan secured on commercial property. It is usually directed at those SMEs that are seeking to acquire or refinance their commercial property. Most commercial mortgages have a variable interest rate and their length usually ranges from three to 25 years, thus making them more suitable to finance long-term financial goals.

30. The Charterhouse BBS suggests that in 2014 business loans and commercial mortgages were used by 18% and 6% of SMEs respectively.[17]

Asset finance

31. Asset finance consists of various finance packages which can be used by a customer to purchase or lease assets. The most common forms of asset finance include leasing (finance and operating leases) and hire purchases. Under leasing and hire purchase the lender owns the assets and rents them out to the business. Under hire purchase, at the end of the lease period the business is also given the option to purchase the assets.

32. Asset finance is commonly used in the purchase of capital equipment, which could vary from large value items such as plant and machinery and vehicles, to 'soft assets' such as ICT software and fixtures and furnishings. Around 80%

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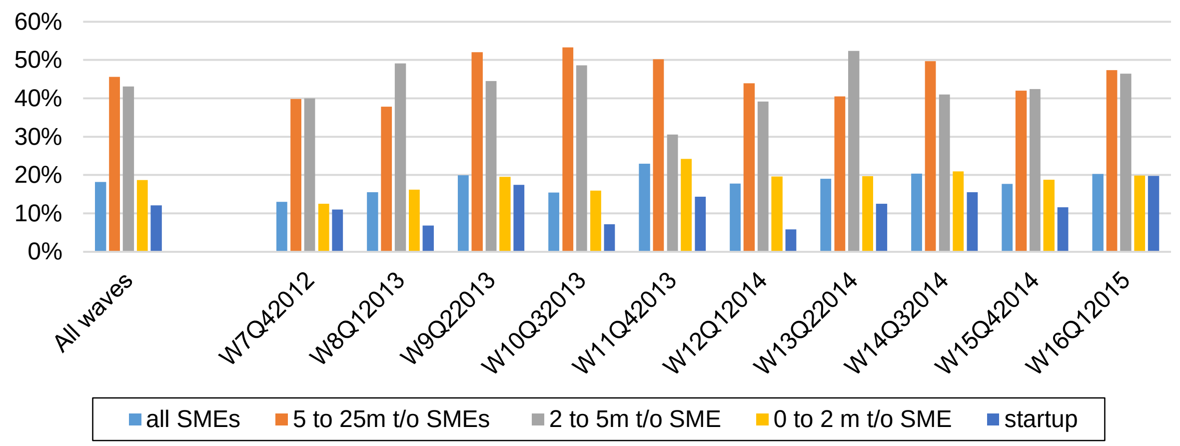
[16] As noted in paragraph 15, our view is that equity finance is different from other financing options and, for the purposes of our investigation, we focus on debt-based finance only.
[17] Charterhouse BBS 2014.

of asset finance is used to finance the acquisition of vehicles or industrial equipment,[18] suggesting that it is mostly suitable for medium- or longer-term funding. Asset finance is also provided by other companies, such as GE, Siemens and Hitachi, originally to assist the purchase of their own products and is therefore highly specialised.

33. Some parties have also suggested that the rise of asset finance is a strong competitive constraint to lending more generally.[19] Whilst we see that asset finance is an alternative to some types of finance we note that it is primarily used by larger SMEs (see paragraph 12), and that it has not materially increased as a proportion of all external finance in the last few years (see Figure 11).

Figure 11: Asset finance as a proportion of all external finance over quarters (2012 Q4 to 2015 Q1) (UK)



Source: SME Finance Monitor, Q4 2012 to Q1 2015.
Base: All SMEs taking out finance: All waves: all SMEs (27,315), start-ups (1,962), £0–£2m (20,211), £2–£5m (2,406), £5–£25m (2,736); individual wave ranges: all SMEs (2,399–2,962), start-ups (149–233), £0–£2m (1,842–2,105), £2–£5m (158–305), £5–£25m (151–397)

34. In 2014 asset finance was used by 6% of SMEs.[20] However, due to its characteristics, asset finance is more suitable for certain types of SMEs and is more prevalent among the larger SMEs.

Invoice finance

35. Invoice finance (factoring and invoice discounting) is a form of finance where an SME can transfer claims on outstanding invoices to a finance provider

[18] British Business Bank, *Small Business Finance Markets 2014*, p38.
[19] In particular HSBCG noted that 'Specialist invoice finance, asset finance and peer-to-peer lending providers provide a competitive constraint on the provision of both these specific forms of financing and on more conventional financing methods, such as general purpose business loans and overdrafts'. RBSG noted 'Increasing activity within SMEs to make investment has been evidenced in reported figures from the Office of National Statistics and corresponding growth in the use of Asset Finance has been seen'.
[20] Charterhouse BBS 2014.

who, in exchange for a fee, transfers a certain percentage of the outstanding invoice value upfront in advance of payment of the invoice. Banks typically finance up to 85% and 90% of the value of outstanding invoices.[21] The difference between invoice discounting and factoring is that under the former the SME owns its sales ledger and is responsible for the collection of payments, whereas under factoring the SME hands this to the bank to manage and collect the debt. Therefore factoring usually also incurs higher charges. The nature of this product makes it similar to an overdraft and a useful tool to manage SMEs' cash flows.

36. Banks have told us that invoice finance has been used as an alternative to overdrafts and loans, and could be an important source of working capital. However invoice discounting takes some time to set up. Some banks have told us that it can take a number of months from application to receiving finance. This suggests it would not be so useful when finance is required at short notice. We also note that while invoice finance is used to solve cash flow issues (as overdrafts and credit cards may be), as it takes quite some time for a bank to set up, it is less desirable for unexpected cash flow issues.

37. 5% of SMEs were reported to have used invoice finance in 2014.[22] However, it is only suitable for certain types of SMEs in relation to certain forms of borrowing and is most commonly used by larger SMEs.[23]

Alternative finance

38. Alternative finance includes internet based peer-to-peer lending, crowdfunding and invoice trading platforms which directly match potential lenders to potential buyers without involving a bank (see Appendix 2.1 for more information on different types of alternative finance and the biggest lenders):

(a) Crowdfunding is a form of lending that allows many people to contribute small amounts of funding with the view of obtaining a combined total that meets the businesses lending target. Crowdfunding is typically delivered through a platform, which can be focused on either debt or equity and can take various forms, depending on the expected reward.

(b) Peer-to-peer lending is a form of crowdfunding of loans. It is done through a platform that matches borrowers to lenders which then agree on a secured or unsecured loan.

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[21] In particular [✂] and [✂] have indicated financing up to 85%, [✂] – up to 90%.
[22] Charterhouse BBS 2014.
[23] BDRC, SME finance monitor, Q4 2014, p56.

(c) Invoice trading is a form of lending where businesses sell their invoices or receivables to a pool of individual or institutional investors.

39. Alternative finance has been growing very rapidly over recent years. It has been estimated that the alternative finance markets grew by around 160% in 2014.[24] Despite the rapid growth, alternative finance currently accounts for a very small share of SME lending (in 2014 alternative finance accounted for less than 2% of SME lending).[25] In addition, awareness of alternative finance is low, with only 24% of SMEs being aware of peer-to-peer lending and 21% of invoice trading. Awareness of other types of alternative finance was even lower and only 8% reported having tried some type of alternative finance.[26] Similarly, the SME Finance Monitor reports that in 2014, whilst 27% of SMEs were aware of crowdfunding only 1% of SMEs were using it. Only 30% of those aware of crowdfunding said that they would consider applying for it in future whereas 63% said they would not.[27] On the other hand, peer-to-peer borrowers reported being happy with the service, 86% of them indicating that they were likely to approach a peer-to-peer platform even if a bank offered similar terms.[28]

40. Our view is that the sector's future growth possibilities depend largely on individual investors' willingness to lend and therefore are very difficult to estimate. However, current developments suggest that the importance of alternative finance providers will continue to increase in the future.[29]

41. As noted in paragraph 6 some types of finance are more suitable for certain SMEs or for particular timing and lending needs. If an SME requires finance at short notice it will need to find a lender who will be able to make a decision quickly.

42. Around one-quarter of SMEs thought that alternative finance platforms were faster and more flexible than traditional banks, making alternative finance platforms an attractive option when SMEs need quick and easy access to

[24] Nesta and the University of Cambridge (2014), *Understanding alternative finance: The UK Alternative Finance Industry Report 2014*, p12.
[25] British Business Bank, *Small Business Finance Markets 2014*, p53.
[26] Nesta and the University of Cambridge (2014), *Understanding alternative finance: The UK Alternative Finance Industry Report 2014*, pp25 & 26.
[27] BDRC (2015), SME Finance Monitor, Q4 2014, p275.
[28] Nesta and the University of Cambridge (2014), *Understanding alternative finance: The UK Alternative Finance Industry Report 2014*, p31.
[29] In April 2014 the FCA began regulating investment-based crowdfunding and peer-to-peer lending. The government backed business finance partnership scheme also includes peer-to-peer platforms and several banks have reported forming relationships with peer-to-peer service providers to cross-refer their customers and increase SME access to finance. In its 2014 Autumn Statement, HMT also expressed its intentions to review financial regulation, which it noted currently stands in the way of institutional lending through peer-to-peer platforms.

funds.[30] For instance, a loan from Funding Circle, the biggest provider of peer-to-peer business loans in the UK, can typically be obtained within a week.[31] SMEs can also sell their invoices via online invoice trading platforms and receive the funds in 24 hours.[32]

[30] Nesta and the University of Cambridge (2014), *Understanding alternative finance: The UK Alternative Finance Industry Report 2014*, p27.
[31] See the Funding Circle website. It takes two working days for the business to have its application assessed and a risk rating assigned and up to an additional seven days to have the loan funded by investors. We note however that banks have told us that they can issue loans within this timescale also.
[32] MarketInvoice, the biggest invoice trading specialist in the UK, can provide finance within 24 hours.