# Retail banking market investigation: provisional findings report

## Appendix 9

Appendix 9.1: Further evidence from banks on competition for small and medium-sized enterprises

# Further evidence from banks on competition for small and medium-sized enterprises

1. This appendix provides supporting evidence for Section 9 with regard to:

   *(a)* BCAs;

   *(b)* lending;

   *(c)* customer acquisition strategies; and

   *(d)* cross-selling of other SME products.

## BCAs

### *History and rationale of free banking for start-ups and switchers*

2. Introductory offers in the form of free banking for start-ups and switchers have been a common feature of the SME banking market since at least the 1990s. Variations in the length and conditions of free banking have been driven in response to rivals' offers. HSBC was the first bank to introduce free banking for start-ups and for switchers in 1986 and 1998 respectively. Other banks soon followed and introduced free banking for start-ups in the early 1990s to attract new customers.

3. Prior to this, most banks charged their SME customers for their banking services. Santander, which inherited its SME banking business when it acquired Abbey National and Alliance & Leicester in 2010, told us that both Abbey National and Alliance & Leicester had offered free banking (for day-to-day transactions) to most of their SME customers prior to the acquisition. This had been part of their strategy to establish both brands in the market through a 'very obvious' differentiator to the big four banks at the time, particularly as neither brand was known for serving businesses. [✂] Following the acquisition, Santander in November 2011, started to offer a fixed fee (tariff) banking proposition and only offered a 'fee free' period for start-ups (for day-to-day transactions).[1]

4. Banks told us that the main reasons they offered free banking to start-ups and switchers were the following:

[1] Which we view as more in line with its larger competitors.

*(a)* To minimise the cost of banking during the start-up phase:

(i) Barclays told us that as part of its citizenship agenda it considered it should offer assistance to start-ups. Approximately half of start-ups would typically close in the first three years primarily due to cash flow pressures. If Barclays could assist during the start-up phase it was not only good for SMEs, but may also benefit Barclays in the longer term.

(ii) Santander told us that its free banking policy for start-ups was designed specifically to cushion the cost of banking, whilst the business was starting-up.

(iii) RBS told us that it offered free banking to start-ups to ensure SMEs had the best possible chance to test their idea at as low a cost as possible. It hoped that once the two years were over, the ‘goodwill’ generated by the two-year free banking period would increase the chance of its customers maintaining and even expanding their banking relationship with RBS.

*(b)* To compensate SMEs for the cost of switching banks:

(i) LBG told us that established businesses might experience costs in switching, mainly attributed to the transfer of lending facilities (eg security and valuation fees, and arrangement fees). Switcher offers might therefore be offered to encourage a business to switch all of its financial services needs as well as to migrate any associated cost in establishing its new facility.

*(c)* The policy was commercially viable for banks, ie the income generated from these customers over time more than compensated for the incremental cost of acquisition:

(i) HSBCG told us that many of the free banking customers would generate future revenues from fees paid after the period of free banking expired and from other products and services they purchased from the bank. They would also generate incremental income from the deposits they maintained.

(ii) Barclays told us that free banking was commercially viable to it because some start-ups went on to become very successful middle-sized businesses and indeed progressed to become larger corporates.

(iii) LBG told us that it continued to earn income from other income streams related to start-ups and switchers including net interest income from the balances of these customers. Further, the income these customer groups generated was positive during the free transactional banking period, and the cumulative income of these customers exceeded the cumulative incremental costs during the [✂] year of their tenure with LBG.

*(d)* **In response to competitive pressures:**

(i) RBS told us that its initial policy was to charge for all accounts, with free banking subsequently being introduced as an incentive to improve customer acquisition in a very competitive market.

(ii) RBSG also told us in respect to Ulster that the decision for Ulster not to charge transaction fees to start-ups was made around eight years ago to follow competitors such as Santander, BoI and AIB, which had taken similar steps.

(iii) LBG told us that at various points in time, providers had offered discounted transactional fees for periods between 12 and 24 months with additional benefits such as discounts on accounting packages and business support services. The duration of the discounted offers were influenced by customers' needs and competitors' offers. Historically, Lloyds TSB had varied its start-up discount offers over time as a direct response to competitor offers. For example, in 2003, following the price controls introduced by the 2002 SME banking investigation by the CC, Lloyds TSB offered a three-year discount, providing 100% discount for one year, a 50% discount in year two, and a 25% discount in year three. At the time competitors were also offering a range of start-up discounts, (such as Barclays 12 months free transactional banking), which in some cases were linked to existing PCA relationships, eg HSBC offered an additional 12 months on top of the 12 months of free banking if customers held a PCA with HSBC and NatWest offered an additional six months for customers that held a PCA with it.

***Recent developments in free banking offers to switchers***

5. There has been some variation in free banking periods for switchers:

*(a)* RBSG told us that it withdrew its offer of free banking for switchers in 2014 as part of RBS and NatWest's strategy to end teaser rates across all brands for personal and business customers. It replaced the offer with a

flat rate cash contribution of between £150 and £250 to cover SME switching costs.

(b) Santander told us that it did not currently offer a period of free banking for switchers, as its rationale for the free banking period to assisting start-ups was not relevant to switchers.

(c) LBG told us that it had reintroduced six months free transactional banking for SME switchers in December 2014 following its withdrawal in 2013.

(d) HSBC had recently (February 2015) revised its policy for switchers, increasing the length of free banking from six months to 12 months. This followed no change in the free banking period for switchers since 2012.

(e) Handelsbanken told us ''Whether customers are charged for their current account, and if so the amount that is levied, is a decision taken locally in-branch, according to the specific discussions that have taken place between the customer and the account manager.'

6. There does not appear to be any correlation between shorter periods of free banking and declining market share. For example, Santander and Barclays saw increases in their share of new BCAs between 2012 and 2014.[2] HSBC, on the other hand, saw a decline in its market share, despite having a longer free banking period. The main reasons provided by most banks for their reduced focus on free banking in recent years for start-ups and switchers was to focus on offering higher levels of quality of service and improving their banking tariffs for all customers rather than only start-ups and/or switchers.

### *Pricing of BCAs (post free banking)*

7. Most banks have at least two tariffs for smaller SME customers: one tariff for customers who use branches and a lower tariff for customers who use online channels.

8. In the last few years there have been a number of adjustments made to these tariffs; for example:

(a) Barclays: Barclays restructured its pricing in 2013, and has subsequently been migrating all customers to this updated pricing structure. This revised pricing structure led to an increase, albeit a small one, of average current account charges, in relation to its SME customers with turnover of up to £5 million.

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[2] See Section 6

(b) HSBCG: As part of [✂] in 2012/13, HSBCG introduced the Business Direct Tariff (now called the Electronic Banking Tariff) for SME customers with an annual turnover below £500,000. It was developed to provide smaller SME customers that predominately use remote channels (such as online or telephone banking) with a lower cost proposition. It was triggered by HSBCG's monitoring of competitor and new entrant offerings ([✂]).

(c) LBG: In June 2011, LBG introduced the monthly price plan which, for a fixed fee, included a certain number of transactions per month, with extra charges for off-plan transactions. In addition in February 2015, LBG simplified the tariff structure for its Business Banking Electronic Tariff on its Business Banking Extra accounts. LBG stated that it considered that the changes would make it easier for SMEs to better understand the charges they were incurring.

(d) Santander: Santander introduced a fixed fee BCA allowing unlimited transactions included within a monthly account maintenance fee.

(e) Danske: Danske has [✂].

(f) Metro: [✂]

### *Relationship management and service quality*

*Customer satisfaction and service quality*

9. Banks provided some examples of improvements they have made to services to SMEs based on results from these quality and service measures:

(a) Barclays told us that customer satisfaction scores improved, fewer customers left the bank and more new customers were gained due to an initiative based on feedback on satisfaction from the Charterhouse BBS.

(b) Barclays also noted that it monitored the level of customer relationship losses as an indicative measure of the quality of service provided.

(c) Based on complaints data (among other information),[3] HSBCG improved the visibility of charges on tariffs, speeded up customer service queries, and the way it handled complaints.

[3] Other information included: data from market research; internal dashboards; competitor benchmarking; post sales feedback; reviews of out-switchers; monitoring of service level agreement of back office operations and social media.

(d) In 2015, Lloyds' retail business banking set average monthly complaints targets of [✄] complaints, which equates to a 10% year-on-year reduction to the 2014 monthly average of [✄] complaints.

10. Generally attempted improvements in customer service seem aimed at not losing customers, although we do note some instances of trying to win new customers.

*Relationship management*

11. In recent years there have been changes implemented by banks to their provision of relationship managers. For example:

*(a)* Barclays: In May 2014, Barclays announced an internal reorganisation involving the creation of PCB.[4] [✄] As part of the re-organisation, Barclays had been reviewing its relationship model, providing better access to products and services through all channels.

*(b)* HSBCG: As part of [✄], HSBCG had introduced differentiated relationship management propositions based primarily around the size of the SME. In a hearing with the CMA, HSBCG told us [✄]. It told us that it had since made efforts to improve its relationship management offering to ensure a greater number of meetings between relationship managers and relationship managed SMEs.

*(c)* LBG: In 2013/14, Lloyds split its SME banking division in two, as described in Section 2, with one division focused on smaller SMEs (up to £1 million turnover and lending exposure of less than £50,000) and one servicing larger SMEs (turnover between £1 million and £25 million, or lending exposure greater than £50,000 or customers with more complex banking needs). LBG stated that this model aimed to deliver improved relationship management for larger SMEs with smaller portfolios and more customer contact, with a multi-channel approach for smaller SMEs.

*(d)* Santander: Santander has now moved to needs based segmentation where SMEs are grouped by the services and support they require regardless of the size of their turnover. It has also expanded its workforce of local relationship managers (from [✄] in 2014 to target of [✄] in 2015).[5]

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[4] For further details please see Section 2 and Appendix 2.1.

[5] This relates to local business managers for Business Banking only. Commercial Banking has [✄] relationship directors.

## Lending

### *Competitive developments*

12. A number of recent competitive developments in the market have come from banks looking to improve the availability of finance or speed of decisions. For example:

*(a)* Barclays told us 'in July 2014 Barclays launched the ability for customers to get instant lending decisions on line for unsecured borrowing below £25,000. Whilst this new service was principally driven through customer feedback, it was also the result of competitive pressure both from new lending platforms and from competitor banks.'

*(b)* LBG told us that it had recently streamlined its lending applications and affordability assessment for new lending applications up to £[✂] to provide a quicker assessment.

*(c)* HSBCG told us that it was seeking to grow its lending book. It currently had [✂]% of the BCA market, but only [✂]% of gross SME loans. To do this it was (among other things) taking the following actions:

(i) [✂]

(ii) [✂]

(iii) [✂]

(iv) [✂]

13. Other recent developments, namely the offer of discounts and incentives, appear to have principally come about because of government initiatives. The FLS brought about different responses from different banks. For example Barclays provided 2% cashback on loans to boost the amount of resources available. Barclays told us that:

> This differs from other banks who offered the benefit to customers through a reduction in the margin or a fee waiver. Barclays unique cashback proposition was designed to give us a competitive advantage, as it enabled the customer to receive all the benefit upfront and when they need it most (ie when they have a cash requirement), rather than incrementally over the life of the loan through a margin reduction. Barclays saw customers invest the cashback in a range of ways – for example, by investing more in

the underlying project than originally planned. This would not have been possible with Barclays' competitors' FLS schemes.

14. LBG implemented FLS differently, it initially reduced the interest rates on all new term lending to SMEs written from October 2012 by 1% for the full life of the loan. LBG designed its FLS offer to be simple, straightforward and open to all existing and prospective SME customers, in contrast to competitors' more complex propositions.

15. LBG commented that:

> The response of competitors to FLS varied: certain institutions (for example, HSBC) chose not to participate, while others offered a range of discounts (for example, RBSG reduced the interest rates on certain loans by 1.7% - excluding lending to the property sector - while Barclays introduced a 2% cash-back offer on certain business loans with a term of three years or more). Responding to this, and in order to reach its ambitious lending targets in respect of SMEs, LBG has introduced additional discounts on a series of loans on a targeted basis. The discount for these loans was increased by a further 1% (ie 2% in total) below the pricing guidance matrix. There have been tranches of double-discount loans, occurring in the fourth quarter of 2012, the first quarter of 2013 and the third and fourth quarters of 2013.

***Responses to competitors***

16. Whilst banks do not compete publicly on prices, some SMEs, in particular larger SMEs, can negotiate with banks, including stating what they consider they could achieve with other banks. For example:

    *(a)* LBG told us that loan pricing was inherently bespoke in nature. When setting prices for term loans and overdrafts it based these on a wide range of factors including whether the customer had been offered terms by a rival bank or was threatening to move some or all of its products to a rival provider, the bespoke terms represented a competitive offer to keep that customer. For example, some large SMEs conducted a tender-like process to procure the best banking in terms of service and price.

    *(b)* Similarly, Barclays told us it [✂].[6]

[6] [✂]

17. Meanwhile, despite not participating in FLS, HSBC launched a number of lending initiatives in response to competitive pressure. This included an SME lending fund where in 2014, it allocated a total of £5.8 billion to [✂] of its Commercial Centres across the UK, as well as the [✂] campaign (a direct response to FLS which has continued).

### Customer acquisition strategies

#### *Advertising/promotion*

18. There is evidence of more targeted advertising by banks to either retain or acquire SMEs, often using digital advertising, or targeted direct mail. For example:

    *(a)* [✂]

    *(b)* [✂]

    *(c)* LBG told us that in the last three years, above the line ("ATL") mass media communications have formed a core part of LBG's marketing strategy to SMEs. LBG uses a mix of TV, radio, press, "out-of-home" ("OOH") and digital display advertising. These advertising methods are, according to LBG, particularly effective in raising brand awareness and consideration [of a bank by SMEs].

    *(d)* RBSG has run a number of campaign initiatives across BCAs and core lending products.

19. Evidence from Mintel (Table 1) shows that advertising expenditure by the largest five banking groups on SMEs was £24.7 million in 2013. This compares to £160 million for PCAs.[7] Advertising expenditure has risen every year since 2009.

[7] Mintel (2013), 'Consumers and retail banking (UK)', p47, Figure 35.

**Table 1: Advertising expenditure on Business Banking services, by the top seven providers of small business bank accounts (2009–2013)**

| 12 months to 30 September | 2009 £m | 2010 £m | 2011 £m | 2012 £m | 2013 £m | 2012/13 % change | 2013 % share |
|---|---|---|---|---|---|---|---|
| Barclays* | 2.87 | 1.91 | 6.38 | 6.41 | 6.81 | +6 | 16 |
| HSBC | 5.25 | 3.97 | 1.79 | 6.11 | 5.98 | -2 | 14 |
| Lloyds Bank | 0.56 | 2.51 | 2.31 | 3.16 | 5.81 | +84 | 13 |
| NatWest | 0.58 | 2.75 | 2.16 | 1.48 | 3.08 | +108 | 7 |
| Santander | 0.22 | 0.40 | 0.57 | 2.74 | 2.03 | -26 | 5 |
| Royal Bank of Scotland | 0.63 | 0.39 | 0.65 | 0.38 | 0.71 | +86 | 2 |
| Bank of Scotland | 0.20 | 0.18 | 0.02 | 0.02 | 0.32 | ++ | 1 |
| **Sub-total of listed banks** | **10.30** | **12.11** | **13.87** | **20.28** | **24.74** | **+22** | **57** |
| Others | 12.19 | 17.56 | 17.89 | 17.78 | 18.80 | +6 | 43 |
| **Total** | **22.49** | **29.67** | **31.76** | **38.06** | **43.54** | **+ 14** | **100** |

Source: NMR/Mintel.
*Includes Barclaycard.
++Denotes significant increase.

### *Role of intermediaries*

20. We have found little evidence of banks using intermediaries to acquire new customers. Whilst there was some referral behaviour, this tended to be more informal than formal, and more based on personal contacts than financial relationships.

### Cross-selling other SME products

21. Whilst banks may try to attract new customers for their products, they may so seek to encourage existing customers to take out new products or renew existing facilities. For example:

   *(a)* [✂]

   *(b)* [✂]

   *(c)* HSBCG focuses on relationship banking and building long-term relationships with customers to provide them with appropriate solutions to meet their banking needs. Rather than engaging in non-targeted product marketing campaigns, it primarily markets its products through its frontline staff as they build and maintain customer relationships.

22. Much of the cross-selling takes place in the context of relationship managers, with both HSBC and LBG telling us that they use their relationship managers to offer products to customers. Given a bank has more detailed transactional information for its existing customers when considering lending decisions, it is not surprising to find much marketing activity aimed at existing customers rather than new customers.