



CMA Retail Banking Market Investigation: working paper on SME comparison sites

Response by Funding Options

21st March 2016



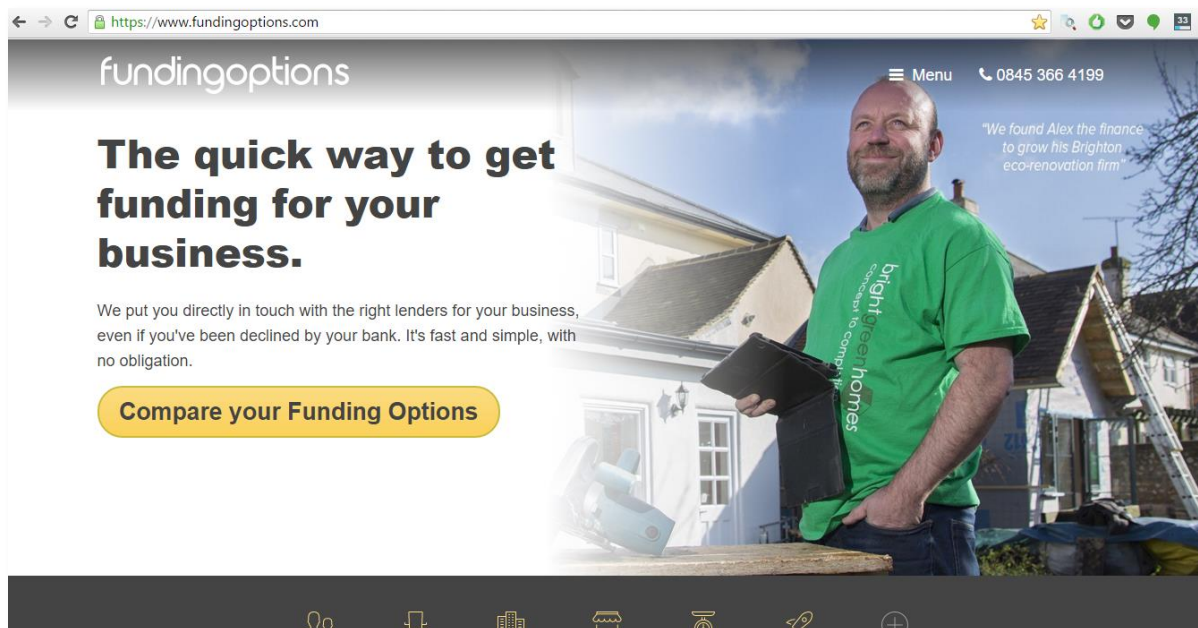
Introduction

Why is Funding Options needed?

Each year, hundreds of thousands of UK firms don't fit mainstream lending criteria, often because they are early-stage, high-growth or in difficulty. Government statistics show that most firms spend less than two hours researching funding options, and two-thirds only approach one finance provider. A single intelligent gateway is required to the diverse range of alternative finance options, with a large economic prize at stake for the UK economy. A recent report by Cambridge University's Centre for Alternative Finance and GLI found £20bn lost to the UK economy each year through lack of alternative business funding awareness. Recent Funding Options research shows continuing challenges for traditional finance, with 30% of SMEs having overdrafts withdrawn or reduced in the last two years, and more than £5m in overdrafts withdrawn daily¹.

What is Funding Options?

Funding Options is a one-stop-shop for SME finance, combining sophisticated online matchmaking technology, with access to business finance specialists where required:



The screenshot shows the 'Step 1 - Answer Questions' section with the following details:

- Your funding needs: (empty)
- Your business:
 - What's the legal status of your business?: Limited company (Ltd)
 - What is the company number?: 09004763
 - How established is your business?: Revenues of 1-2 years
 - What is your typical monthly turnover?: £50,000
 - How profitable is your business?: Slightly profitable
 - Which best describes your sector?: Manufacturing

At the bottom of Step 1, there is a '52% Confidence' indicator and an 'Apply for Finance' button.

The 'Step 2 - Choose from 8 Funding Options' section displays a table of lenders:

Lender	Description	Score	Speed	Cost	Select
Inspired Cashflow	Simple, flexible finance against your customer invoices.	96	Weeks	Low	Select
fleximize	Loans repaid as a percentage of revenue	92	Days	High	Select
mi	Sell one or more customer invoices.	89	Days	Medium	Select
GOLDCREST	Flexible, bespoke lending to support trade	87	Weeks	High	Select
LEGION TRADE FINANCE	Flexible, bespoke lending to support trade	77	Weeks	Medium	Select
ipm	Loans and Asset Finance for growth.	77	Weeks	Medium	Select

Following a rigorous assessment process, Funding Options is one of just three SME finance comparison services recommended for designation as a bank referral platform by HM Treasury in the 2016 Budget². This reflects the uniquely proven quality of the Funding Options proposition:

- *Established model* – Our proven combination of online finance matchmaking technology with real experts achieves the highest possible rating of “Excellent” on independent reviews site Trustpilot.
- *Lender coverage* – Last year we referred SMEs to more than fifty finance providers, ranging from challenger banks, to niche asset specialists, to innovative direct lenders and marketplace lenders.
- *SME reach* – We’ve raised finance for small asset purchases through to major property developments, and for SMEs from Devon to the Isle of Skye, and from Norfolk to Northern Ireland.
- *Enterprise infrastructure* – Our platform has been penetration tested by a ‘big 4’ audit firm, our Equifax partnership used by 150k UK SMEs; operations are guided by Treating Customers Fairly.
- *Innovation roadmap* – We support emerging data-driven SME financing journeys, for example our live API integrations feature in HM Treasury’s report “Data Sharing and Open Data for Banks”³.
- *Thought leadership* – We’re an authoritative voice on the high profile issue of SME finance, regularly featuring in major national press such as the Times, Mail, Telegraph and BBC.

What category is Funding Options?

Funding Options is a specialist SME finance comparison site. Mainstream price comparison website (PCW) participants have been unable to develop mature services for SME loan comparison because the technical problem to solve is not primarily one of price, but one of *availability*. Specialist SME finance comparison sites like Funding Options solve this through a technical proposition more akin



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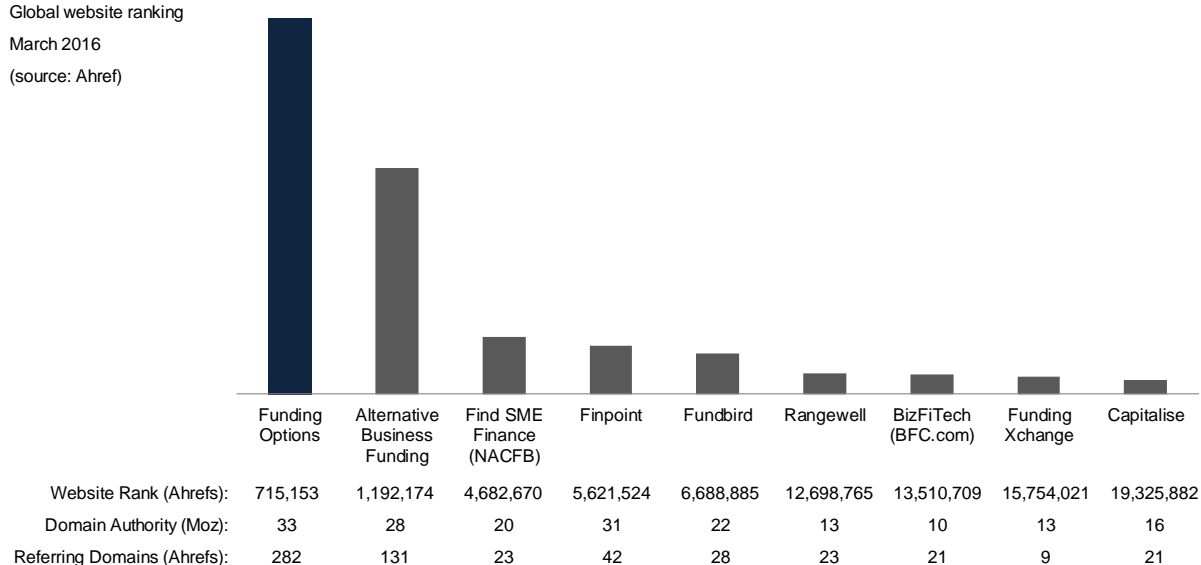
to an online matchmaking service than a PCW. To quote recent public comments from Rishi Khosla, Chief Executive of new challenger bank Oaknorth, “a simple price comparison website would not work as lending needs to be tailored very closely to the characteristics of the business at hand”⁴.

With the growing profile of SME finance challenges, a number of new specialist SME loan comparison sites launched; however, Funding Options is the clear market leader in this category:

Global website ranking

March 2016

(source: Ahref)



Funding Options has already played a role in developing the UK’s world-leading alternative SME finance sector, not just with well-known names (e.g. one of our team was recently Funding Circle’s introducer of the month), but with dozens of smaller alternative finance providers whose websites often feature case studies originally introduced by Funding Options. A selection of public Funding Options SME customer case studies is available at <https://www.fundingoptions.com/case-studies/>.

We would comment that our existing traction within the SME finance market, not least with a model that has evolved and been proven through live market learnings, makes Funding Options uniquely positioned to comment on solutions that will work in practice. Conversely, some rival solutions remain largely speculative and theoretical, and we’d urge the CMA to take account actual traction.



Responses

Scope of comparison services

We emphasise the unique importance of SME finance comparison, and question the market evidence of a compelling demand for BCA comparison services; as such, we support the CMA in championing initiatives that reduce the tie between BCAs and other key SME financial products such as loans.

Given our focused market expertise, we deliberately focus our response specifically on comparison sites for SME finance, and not for wider banking services such as BCAs. Whilst we acknowledge the potential value of PCWs for these wider banking services, we would comment that there is limited evidence that SMEs actually prioritise financial savings on their basic BCA services, or indeed higher BCA service quality; that these aren't important to SMEs may alone explain low BCA switching rates.

Conversely, access to finance unquestionably remains a key challenge for many SMEs, with ~0.25m SMEs rejected for finance by their bank each year, and 30% having had their overdraft withdrawn or reduced in the last two years¹. Solving this real issue by improving access to alternative lending represents an economic prize estimated at £20 billion in additional gross domestic product (GDP).

Precisely because there is little market evidence that most SMEs consider the price or quality of their BCA to be a priority, we strongly support a CMA focus on initiatives that reduce the tie between the provision of BCAs and of other SME financial services such as loans and deposits, including:

- Open Banking initiatives, notably the NESTA Challenge Prize, that will lead to rival financial services providers having better access to crucial BCA data; and
- Improving SME customer access for alternative finance providers who do not offer BCAs, notably the bank referral scheme as part of the Small Business, Enterprise & Employment Act 2015.

Indeed, the SME segment is notable in that SME-focused challenger banks very commonly do not often offer BCAs at all; this suggests that BCAs themselves are not a market opportunity to remedy.

Moving beyond price

We note that a need specifically for “price” comparison services in SME financial services is not backed up by market evidence; we therefore welcome that CMA has largely adopted a more neutral and inclusive language of “comparison sites”, and would urge that this position be more explicit.

We welcome that the CMA has now largely adopted the neutral language of “comparison sites” in relation to SME financial services, rather of “price comparison websites” (“PCWs”). PCW is ‘solutioneering’ that presupposes a particular problem and solution, without market evidence.



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Solving the SME finance problem will take far more than basic *price* comparison tools. For SMEs that can access bank loans, finance is already affordable due to record low interest rates. Indeed, most alternative business finance providers cannot compete with major banks on price, as their funding costs are higher. For example, the invoice finance division of major banks will quietly pass less prime SME customers to independent providers, who often rely on institutional funding from such banks.

Indeed, if the *price* of conventional bank debt were crucial, then SME finance simply wouldn't have been controversial in the last five years, as the absolute cost of bank debt is low because of the exceptional interest rate environment. Instead of price, alternative finance providers largely focus on competing on *availability*, when finance it is unavailable, or too cumbersome, from banks. Common examples where alternative finance providers successfully compete with banks is by taking a traditional bespoke lending approach, or by using innovative new data sources to assess risk.

We note recent public comments from Rishi Khosla, Chief Executive of challenger bank Oaknorth, that “a simple price comparison website would not work as lending needs to be tailored very closely to the characteristics of the business at hand”. This is precisely why mainstream PCW providers have not developed mature SME loan offerings, because unique market challenges do not fit their model.

Equally, SME loan price comparison is very complex, and often misleading. For example, a popular current refrain is of the need for an Annual Percentage Rate (APR) for SMEs. Notwithstanding the often confusing nature of headline APRs, an APR will simply not work for many SME products such as merchant cash advances. A comparable measure of finance Total Cost of Ownership (TCO), dynamically adjusted for scenarios such as full term vs early repayment, is technically possible. However the complexity of such a measure is significant, and there is little evidence of SME demand.

At Funding Options, we believe strongly in letting our customers speak for themselves — any SME using our service is able to leave comments on the independent review site Trustpilot, where Funding Options has the highest possible score of “Excellent”. As such, we strongly support better *service* ratings, and - noting the limited direct market traction achieved by the Business Banking Insight (BBI) ratings (see below) - suggest that BBI ratings are offered across the SME comparison market via an open application programming interface (API), so their positive impact is magnified.

A market-driven approach

We strongly support CMA’s preference for a solution “driven by competition rather than regulatory design”, and comment that this is precisely why HM Treasury invited private sector SME finance comparison platforms to run the SBE&E bank referral scheme.

We strongly support the CMA’s finding that market-driven solutions offer “the best prospect of identifying a sustainable and comprehensive solution to the competition concerns” (5) and that being “driven by competition rather than regulatory design it seems more likely to give rise to

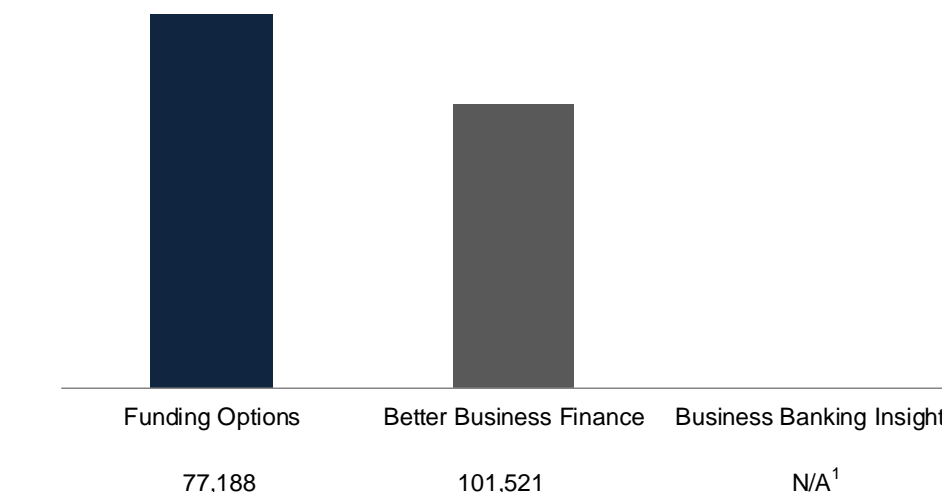


innovative solutions” (53). In addition, we would comment that a private sector, competition-led approach builds on the UK’s world leadership in financial technology (FinTech).

We note that the working paper refers to two non-profit comparison websites, Better Business Finance and the Business Banking Insight, as “the two most developed SME-focused comparison sites” (35). In fact, Funding Options already offers significantly more sophistication than either, and also attracts more traffic according to independent Amazon-owned website rankings service Alexa:

UK traffic ranking

(Source: Alexa)



⁽¹⁾ Business Banking Insights attracts insufficient traffic to gain an Amazon Alexa rating).

We note the similarities in the CMA’s proposed competition-led approach, to the bank referral scheme enacted as part of the Small Business, Enterprise & Employment Act (SBE&E) 2015, where HM Treasury decided to allow “the private sector to develop multiple competing platforms – allowing for competition to drive up the standards and quality of the service”. Whilst we fully support the NESTA Challenge Prize, we believe that narrow focus *only* on this initiative does not take advantage of the extensive assessment process already undertaken as part of the SBE&E bank referral scheme, to select compliant and secure SME finance comparison platforms².

The NESTA Challenge Prize is predicated on an untested hypothesis that access to Open Banking application programming interfaces (APIs) could be transformational for SME financial services, which inherently includes speculative assumptions around future SME behaviours. Indeed, it is precisely because the outcome is highly speculative, that it is an ideal for a challenge prize. Equally, the major banks may struggle with API implementation and governance, giving further risks to a successful outcome. As such, we do not believe that the CMA’s SME comparison remedies should rely *solely* on the NESTA Challenge Prize. We would note that an attempt to create a similar remedy in the 2002 Competition Commission inquiry, Portable Credit Histories (PCH), failed to gain traction⁷.

Therefore, *in addition* to giving its backing to the NESTA Challenge Prize, there is no reason why the CMA cannot encourage banks to also give more prominence to the compliant referral platforms designated as part of the SBE&E. For example, banks can be encouraged to offer these designated



SME finance comparison tools to their SME customers *prior* to a formal rejection. A positive impact on SME lending competition could be dramatic, and far faster than the NESTA Challenge Prize.

The need for regulatory comfort

There is a largely unrecognised prize in giving the major banks more regulatory comfort to work with alternative finance providers. The compliant SME finance comparison services designated as part of the SBE&E provide an immediate solution.

We would comment that major banks are commercially far more willing to collaborate with alternative lenders than is generally recognised, as most alternative finance providers are not competitive providers of BCAs. With pressure on bank lending policies such as Basel III¹, alternative finance can help banks' SME customers to survive and grow. For example, it was Funding Options that arranged financing that saved Ruthin Castle, a hotel employing 100 in rural Wales, after their bank had withdrawn support; the bank in question is well aware that positive reporting by the BBC⁵ would have been a fundamentally different if the hotel had not been saved by alternative finance.

Ironically, it is often *regulatory* concerns that prevent better collaboration between major banks and alternative finance providers, particularly a perception that the Financial Conduct Authority (FCA) will hold banks accountable for adverse outcomes for the SME being referred, and also concerns that the bank may unwittingly carry out regulated Credit Broking activities. With more regulatory confidence on these points, major banks will more actively support the alternative lending market.

Indeed, Funding Options anticipates that over time banks will feel comfortable with commercialising this flow of SME referrals to alternative lenders, as is the norm in many areas of consumer finance. It is often the unique political sensitivity around SME lending that prevents such commercial solutions.

The SBE&E bank referral scheme directly addresses bank concerns, firstly via the regulatory comfort of legislation, and through the thorough assessment process on the infrastructure, proposition and compliance of designated SME comparison platforms. This is another reason why Funding Options believe that the CMA has underestimated the potential value of HM Treasury's imminent bank referral scheme in driving adoption of SME finance comparison services. As such, we urge the CMA to further consider how the SBE&E bank referral scheme can enhance competition in SME lending.

ENDS

(supporting reference overleaf)



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