Boosting Local Business.

Local banking for Britain

TSB

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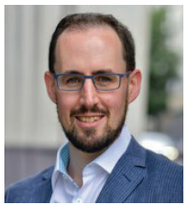
Foreword.



Small businesses are the engines of economic growth and prosperity, fuelling local economies right across Britain. In 2018, the nation's 5.7 million small businesses had a combined annual turnover of over £2 trillion – that's 52 per cent of all private sector turnover in the UK.[1]

They are also the private sector's biggest employers', accounting for 60 per cent of all private sector jobs and employing 16.3 million people.[2]

But in the aftermath of the financial crisis, and at a time when the economic outlook and the UK's future trading framework are uncertain, small business confidence is now 30 points lower than it was four years ago.[3] This is discouraging many small businesses from investment and growth.

At the same time, SME productivity is flatlining and is now just half that of the UK's largest companies. What's more, it's the SMEs in our local economies that are the hardest hit.

Part of the problem, and therefore the solution we need to develop, is finding ways to better enable SMEs to access and gain benefit from technological change.

Larger companies often find it easier than SMEs to access the benefits that new technology can bring.

And while some SMEs are trailblazing new solutions to start, run and grow their businesses more effectively, not every SME and local economy has equal access to the tools, advice and support they need to embrace digital solutions.

In this environment, it is more important than ever that **all** small businesses are provided with what they need to thrive.

We believe banks must play a key role in this – both in improving business banking services, and also collaborating with a range of partners to help provide local access to the advice, technology and services that small businesses need.

> **“ Giving small businesses access to great banking and business support services could unlock productivity and deliver a boost of up to £70bn to the economy. ”**

In order to achieve this and remove the current barriers to the ambition of our nation’s SMEs, we believe that:

- **Banks should improve their small business offer, to help small businesses all around the UK access best in class technology and business services.** Most business banking services offer little beyond basic transactional services and do not give SMEs the added value they need to thrive.
- **Banks should help provide access to local advice and support to help small businesses manage and grow their businesses.** A focus on connectivity and enterprise in large cities, combined with branch closures and cutbacks to relationship managers, has resulted in small businesses outside of metro economies having less access to key advice and support networks.
- **Banks should come clean on fees and charges.** There is a lack of transparency and poor pricing practices in business banking, which is leaving many small businesses stuck on poor deals. All too often there is a ‘penalty for loyalty’ where existing customers get poor rates – for example the two-thirds of businesses that save.
- **Banks and regulators need to put greater focus on helping small businesses to borrow well and provide them with the protections they need should they enter into financial distress.** Limited choice and insufficient protections for those that borrow has resulted in many businesses losing the confidence to invest and grow.

The benefits are considerable.

By giving small businesses access to the tools and advice needed in a digital age, regardless of where they are located; enabling them to benefit from fair fees and charges; and by ensuring they are protected should things go wrong; small businesses will benefit from increased productivity and business confidence.

Ultimately, giving SMEs access to great banking and business support services could unlock productivity, creating time savings for business owners, as well as opportunities for growth.[4] Research from Oxford Economics shows that if all small businesses in Britain realised these productivity gains, it could deliver an up to £70bn boost to UK GVA.[5] Even if only one in ten small businesses were to benefit from better banking and business support, the impact on our economy would be significant.

At TSB, we hope that by shining a light on a key opportunity to help small businesses and committing to roll out a new business banking offer over the coming months, we will be able to play our part in unlocking this huge potential for the UK.

Richard Davies
Commercial Banking Director, TSB

1 The UK's SME productivity challenge

SME productivity is flatlining while the productivity of the UK's largest companies is on the rise[6]

Ninety-nine out of every 100 UK businesses are small businesses and their numbers continue to grow each year. In the last year alone, the UK has seen the population of small businesses rise by 197,000, and since 2000, there has been a net increase of 2.2 million.[7]

But while their numbers have risen, small business productivity has stagnated since 2010 and is now just half that of the UK's largest companies.[8]

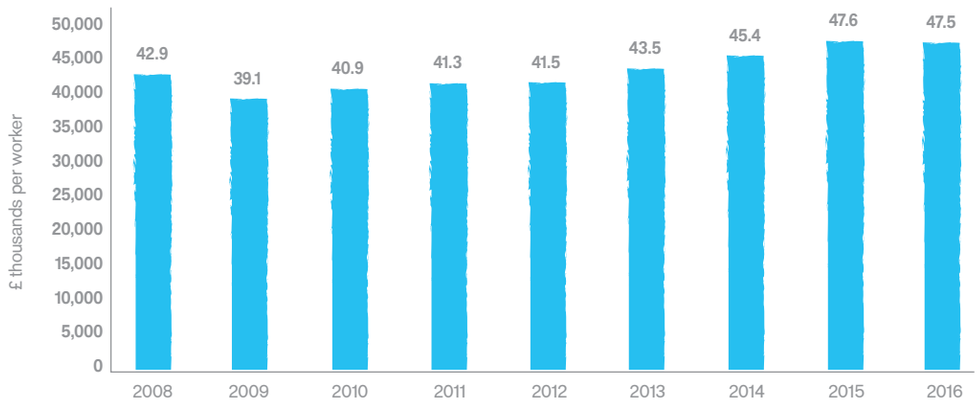
Small businesses outside of the big cities have been the hardest hit. Small businesses in London are now three-and-a-half times more productive than those in Wales. And across the UK, the most productive small businesses, largely in metro economies, produce 26 times the turnover of the least productive business who are mainly found in regional economies.[9]

This report from TSB, built on research carried out by Oxford Economics and YouGov, collectively spanning more than 1,100 businesses, sets out a new approach to small business banking that could transform the productivity of UK small businesses.

In fact, unlocking the untapped potential of UK small businesses through a new approach to business banking could boost productivity amongst small businesses right across Britain by up to 10 per cent, delivering a £70 billion boost to GDP.[10]

Even if only one in ten small businesses were to benefit from better banking and business support, the impact on our economy would be significant.

Productivity (output per worker, £ thousands) by for Small and Medium-sized Enterprises (between 1 and 249 employees), constant 2014 prices



2 Small businesses need more from their banks

A new approach to small business banking could transform the productivity of UK small businesses

In order to compete, small businesses need to feel confident to invest in their future and to adopt practices that save time and help them to run their businesses more effectively.

Small businesses need more from banks than just good financial services. They also want access to the right technologies, support and skills to keep up with the pace of change.

Our research shows that small businesses believe their banks are holding them back by not offering the right support and focusing on larger, more profitable companies:[11]

Few small businesses believe that they are getting good value from their bank:

- Nearly half of small businesses (47 per cent) believe they pay an unfair amount in business banking charges.[12]
- This is incredibly off-putting for SMEs, 81 per cent of which identified competitive pricing as an important factor in choosing a bank.[13]

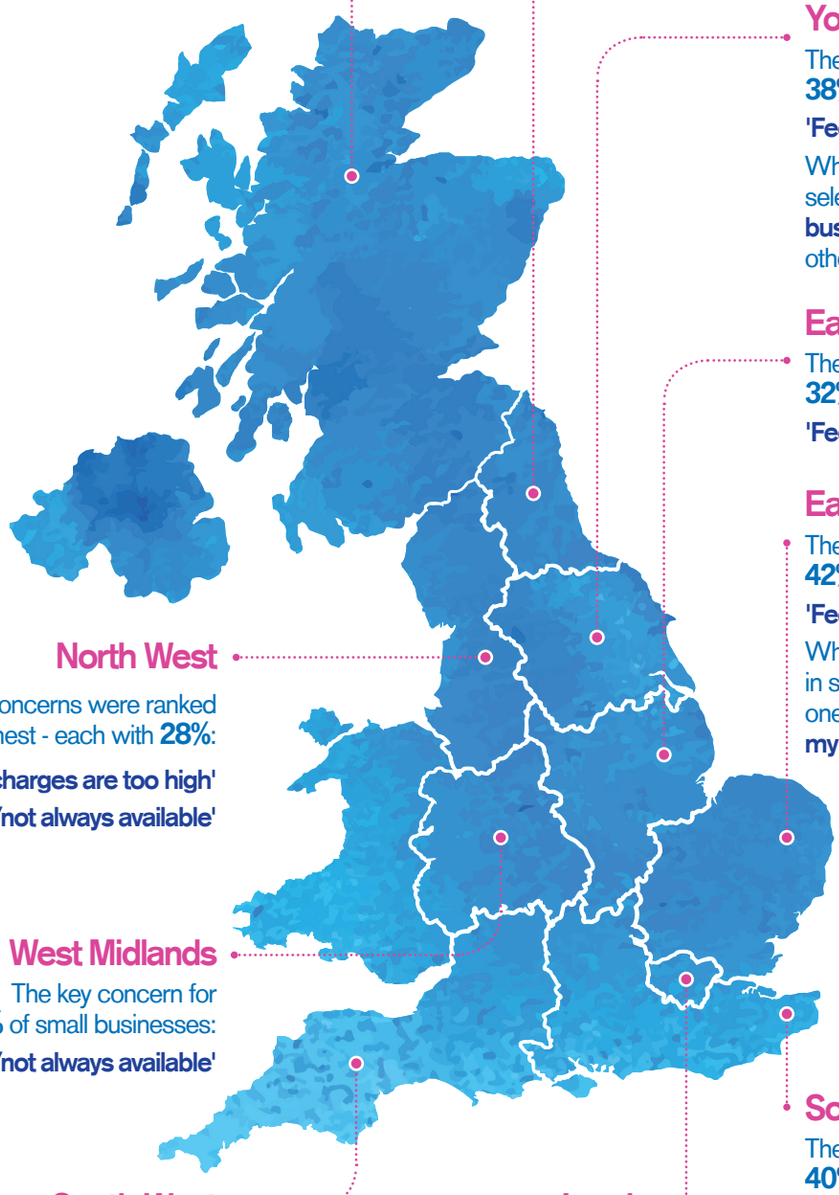
Part of the problem is that small businesses do not feel they are being given the right support by their bank:

- Fewer than half of SMEs (49 per cent) believe that their bank understands their needs.[14]
- 42 per cent of SMEs say that their bank does not actively offer them additional services to meet their needs.[15]
- 42 per cent also believe that this is holding their business back.[16]

Many small businesses believe that a sector focus on larger, more profitable companies is seeing their needs overlooked:

- 68 per cent of SMEs believe that banks focus on larger companies because they consider them more profitable.[17]
- When asked what small businesses would like their bank to do, the number one answer (29 per cent) was to give small businesses the same treatment as larger businesses.[18]

SME's right across the UK are looking for better value from their business banking provider



Scotland

The key concern for **40%** of small businesses:

'Waste too much time/make errors'

North East

The key concern for **38%** of small businesses:

'Fees and charges are too high'

Yorkshire and Humber

The key concern for **38%** of small businesses:

'Fees and charges are too high'

When ranking the key criteria in selecting their bank, **'local to my business'** scored higher than any other region (**46%**)

East Midlands

The key concern for **32%** of small businesses:

'Fees and charges are too high'

East of England

The key concern for **42%** of small businesses:

'Fees and charges are too high'

When ranking the key criteria in selecting their bank, only one region scored **'local to my business'** higher (**44%**)

North West

Two key concerns were ranked equally highest - each with **28%**:

'Fees and charges are too high'

'Reactive/not always available'

West Midlands

The key concern for **38%** of small businesses:

'Reactive/not always available'

South West

The key concern for **32%** of small businesses:

'Reactive/not always available'

London

The key concern for **26%** of small businesses:

'Waste too much time/make errors'

South East

The key concern for **40%** of small businesses:

'Fees and charges are too high'

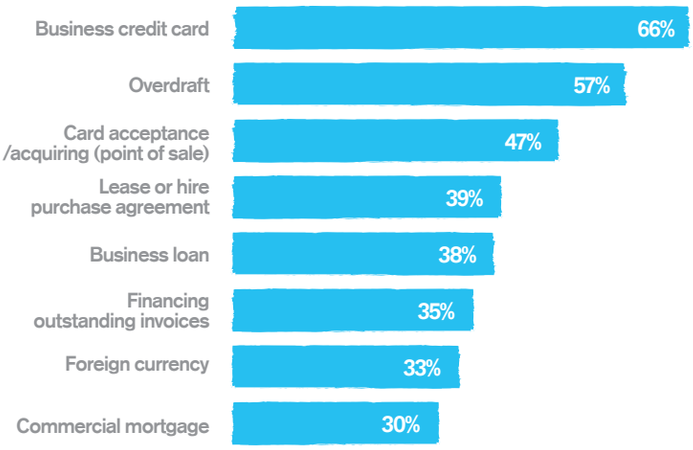
Only **20%** of SMEs use business loans - lower than anywhere else in Britain

Amongst UK small businesses, beyond a business current account, credit card and overdraft, there is a low take up of even basic services – such as business loans – that could significantly help business growth and productivity uplift.

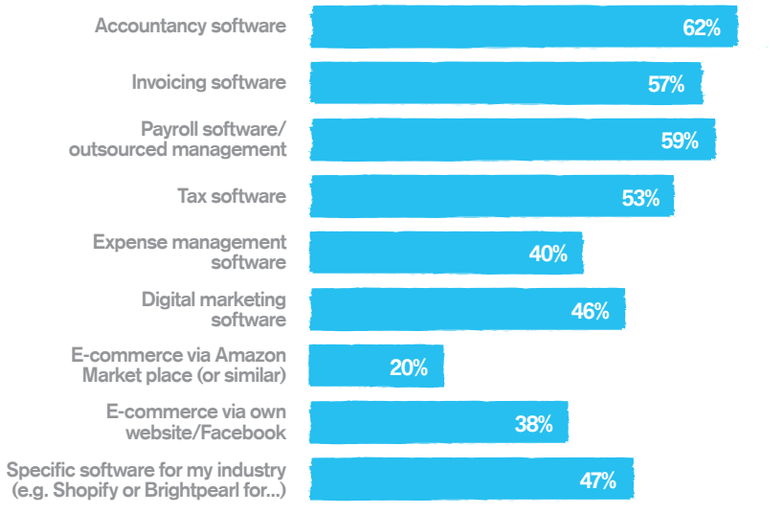
This is resulting in a low take-up of banking products that could help small businesses invest and grow:

- Barely a third of UK SMEs (38 per cent) use a business loan – dropping to just 4 per cent for the UK's smallest companies.[19]
- The lack of protection for small businesses looking to borrow is putting off small businesses from taking up business loans. In fact, 80 per cent are looking to self-fund in the future.[20]

Amongst SMEs there is a low adoption of business banking services



Low SME adoption of back office business support services



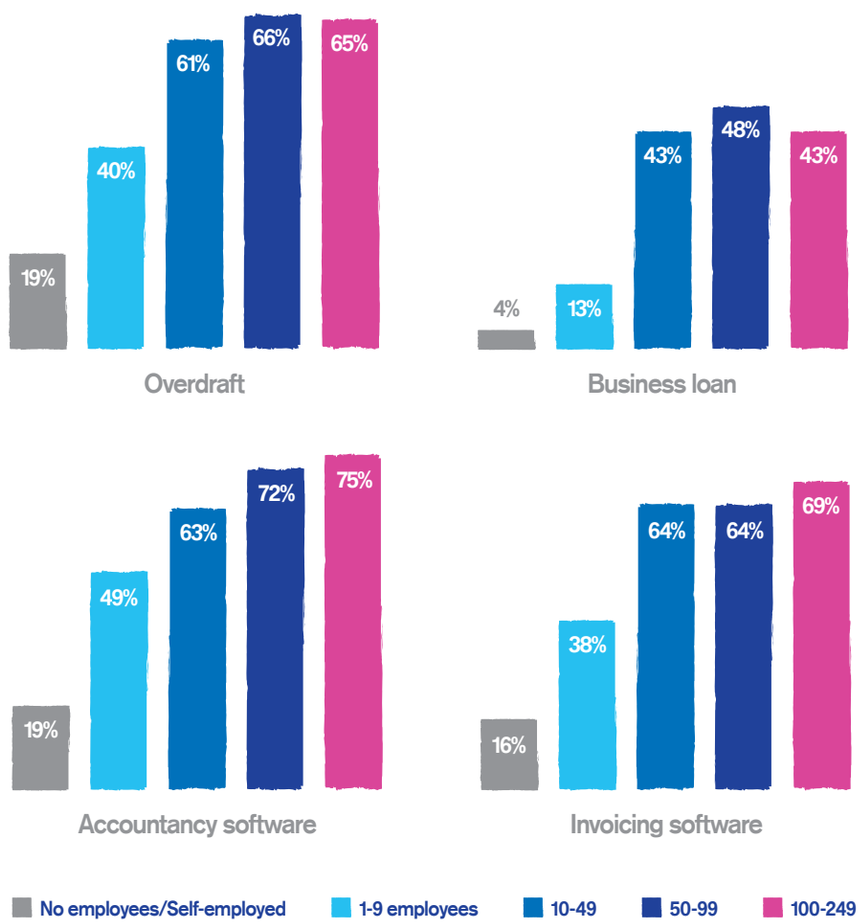
As well as preventing small businesses from taking up new services that could help them become more productive in the future:

- Just a quarter (24 per cent) of small businesses say they have access to advice, tools and services that give their business the confidence to be more digital.[21]
- 60 per cent have no idea what services their bank can offer to help them become more productive and only one in ten (11 per cent) small business have a good understanding of the services available.[22]
- Given this, it's unsurprising that few SMEs are using tools that can improve their productivity.[23]
- When it comes to back office technology, under two-thirds of SMEs are using accountancy software (62 per cent), payroll software (59 per cent) or invoicing software (57 per cent). Just over half (53 per cent) use tax software and only 40 per cent use expense management software.[24]
- Take up of front-office services is even lower. In fact, just over a third (38 per cent) of SMEs use e-commerce solutions via their own website or Facebook and only one in five (20 per cent) use e-commerce solutions via Amazon marketplace or similar.[25]
- Meanwhile, under half (46 per cent) use digital marketing software, and for businesses with 1-9 employees, that number drops to just 11 per cent.[26]

Taken together, the picture is a troubling one. Amongst UK small businesses, beyond a business current account, credit card and overdraft, there is a low take up of even basic services – such as business loans – that could significantly help business growth and productivity uplift.

As SME's grow they use more business banking and business support services, with the greatest potential for increased adoption and productivity uplift on offer for smaller SMEs.

Graphs opposite show the differing level of uptake of business banking and business support services amongst SME's of different sizes.



3 The four factors holding back SME productivity

We believe that there are four key drivers resulting in small businesses not receiving the support they need from the banking sector.

1.

A lack of transparency and poor pricing practices is leaving many small businesses stuck on bad deals.

- The biggest single concern SMEs have with their banking provider is that fees and charges are too high.[27]
- In fact, over half of SMEs do not think traditional banks offer value for money across their services.[28]

Yet despite this widespread dissatisfaction, the lack of transparency around pricing and different services means only 3 per cent of small businesses switch their accounts.[29]

As a result, too many banks deliver a 'penalty for loyalty' where existing customers are offered worse deals than new customers. This is particularly true for the two-thirds of businesses that save, who receive very low interest rates.

2.

Bank branch network reduction and cuts to the number of relationship managers available, both in-store and online, are reducing small businesses' access to vital business banking advice and support.

- Across the UK, banks have closed 2,900 branches in the last three years alone.[30]
- But among UK SMEs, 83 per cent say customer service and 72 per cent say personal service are key criteria when choosing a bank.[31]
- What's more, 72 per cent of SMEs want a banking provider that is local to their business. This number rises to 84 per cent in Yorkshire and Humber.[32]
- These closures have had an acute impact on rural economies and smaller towns. For example, recent research found that the 'huge decrease in bank branches may have exacerbated credit constraints for SMEs in more remote UK regions.'[33]
- Many banks are also cutting back on the number of relationship managers they make available to small businesses.

3.

Small businesses need help adopting ways to improve efficiency, save time, and grow.

- One of the biggest problems faced by small businesses in the UK is that they are forced to waste nearly 300 hours each year on unproductive, but essential, administrative tasks.[34]
- 43 per cent of SMEs feel as though they are being held back because of the administrative time needed to run their business.[35]
- Many small businesses are also unaware of tools to grow their business – at the most basic level only 38 per cent sell products via a website and 46 per cent use digital marketing software.[36] There are also significant opportunities to use e-commerce platforms to grow their business abroad.

Tasks such as managing expenses, payroll and accountancy can be painstaking when done manually, eating into a working day, and often into evenings and weekends. This doesn't allow the time to focus on new growth opportunities. Only one in five (21 per cent) small businesses feel their bank offers them services to help them cut out administrative tasks.[37]

4.

There is limited choice and insufficient protection for small businesses looking to borrow.

- Unlike in consumer banking, there are very few protections in place for small businesses that want to borrow more than £25,000.
- Instead of a regulatory safety net, a large proportion of the business banking market is policed only by 'voluntary standards.' In the past, this has sadly given rise to mis-selling and loan restructuring scandals, leaving small businesses devastated and significantly undermining trust and confidence in bank lending.
- This lack of confidence has contributed to just 13 per cent of SMEs considering applying for bank lending in Q3 2018.[39] Businesses also find themselves lacking direction on where to turn for lending support. In most instances, SMEs initially turn to their main bank for additional funding. If they are then turned away, small businesses are provided with very little support on where to they can find alternative options.[40]

The lack of protection, combined with insufficient professional guidance, has led to many small businesses concluding that business banking services represent a greater risk than the possible reward.

4 Building a better business banking sector

Our research clearly demonstrates that the UK business banking sector can do a lot more to help small businesses thrive.

A sector wide focus on larger, more profitable companies has seen small businesses overlooked, while trust in business banking remains poor and the current suite of products offers no reason for small businesses to think the sector has changed.

An effective business banking sector, collaborating openly with partners, would go a long way to improving the productivity and growth of small businesses.

Based on our research and analysis, there are four key steps that the business banking sector must take to achieve this:

- **Banks should modernise and improve their small business banking offer, to give small businesses access to best in class technology and business services.**
  - Small businesses used to rely on their bank to provide them with financial services that meet their real needs and help them to keep up with the pace of change.
  - In an increasingly digital economy, this means throwing a lifeline to small businesses that are drowning in admin and need help adopting new tools for growth.
  - Providing SMEs with better access to new digital tools that help improve the productivity of their business, such as accountancy software and digital marketing, will help to foster an environment that will enable the nation's hardest workers to win back time and create opportunities for growth.[40]
  - Whether banks provide these services themselves, or broker relationships with third parties like Sage or Xero, these tools are essential to ensure that our nation's small businesses can keep up with the pace of change and have the confidence to grow their business.

> **" While the extension of the Financial Ombudsman Service's remit was welcome, TSB is proud to have been the first bank to support the creation of a bespoke tribunal system that offers small businesses, of any size, an alternative dispute resolution mechanism with which to challenge banks over unfair lending or treatment practices."**

- **Banks should help provide access to local advice and support in all parts of Britain to help small businesses manage and grow. Small businesses need banking partners who want to actively support them and help them grow. SME's need these partners regardless of where they live; whether in a big city or a rural area.**
  - Banks must commit to providing face-to-face local business support in the real economy, not just metro economies, thereby ensuring not just those that are digitally savvy, or based in big cities, are able to get the advice and services that can help grow their businesses.
- **Banks must give small businesses a fair deal. It's time for:**
  - Small businesses to benefit from competitive pricing, rather than be used as a cash cow to subsidise other products and services.
  - Existing customers to be put on an equal footing to new customers. Banks must stop leaving their back-book languishing on poor deals and punishing customers for loyalty. This means offering new deals to existing customers as well as new customers.
  - An end to opaque teaser rates.
- **Banks, alongside regulators, must put a greater focus on helping small businesses borrow well and provide them with the protections they need should they enter into financial distress.**
  - The practice whereby the majority of small business banking is policed by 'voluntary standards' needs to end.
  - Small businesses need adequate protections from the kind of behaviour that has led to mass mis-selling and bank profiteering at times of financial distress.
  - We strongly believe that protections for customers engaging in business lending should have similar regulation to that for consumer lending, to restore business confidence in borrowing.
  - We also believe that more needs to be done to help customers where there is a dispute with their bank. While the extension of the Financial Ombudsman Service's remit was welcome, TSB is proud to have been the first bank to support the creation of a bespoke tribunal system that offers small businesses, of any size, an alternative dispute resolution mechanism with which to challenge banks over unfair lending or treatment practices.

5 Unlocking growth across the UK

Getting this right will unlock growth in every region of the UK

Boosting SME productivity rates is crucial to the UK economy. A business banking system that truly meets the needs of 99 per cent of the UK's businesses would help unlock growth in every region of the country.

Getting the system right would provide a real growth opportunity for every SME, from one-person start-ups, to established businesses with multi-million pound turnovers.

Accessing fairer rates and charges, better choice and protection in business lending, and helping adopt new solutions to increase productivity, can have a big impact on small businesses.

This could equate to a boost in productivity by an average of 10 per cent across the UK for companies of up to 49 employees.

For businesses of up to 249 employees, that figure rises, with the greatest potential in the East of England (13.6 per cent) and Yorkshire & Humber (12.5 per cent).

The net effect of the productivity gain if all UK small businesses were to benefit from substantially improved banking and business services would be an up to £70 billion boost to UK GVA, or up to a 3.5 per cent growth in the size of the economy.[41]

Even if only one in ten small businesses were to benefit from better banking and business support, the impact on our economy would be significant.

As it stands the system is too often failing the small businesses that drive the UK economy. Reforming banking and business support to allow these companies to grow is not an opportunity the UK can afford to miss.

“This could equate to a boost in productivity by an average of 10 per cent across the UK for companies of up to 49 employees.”

The opportunity for UK regions

Scotland
£4.64bn boost for the UK economy
10.2% potential productivity increase for small businesses

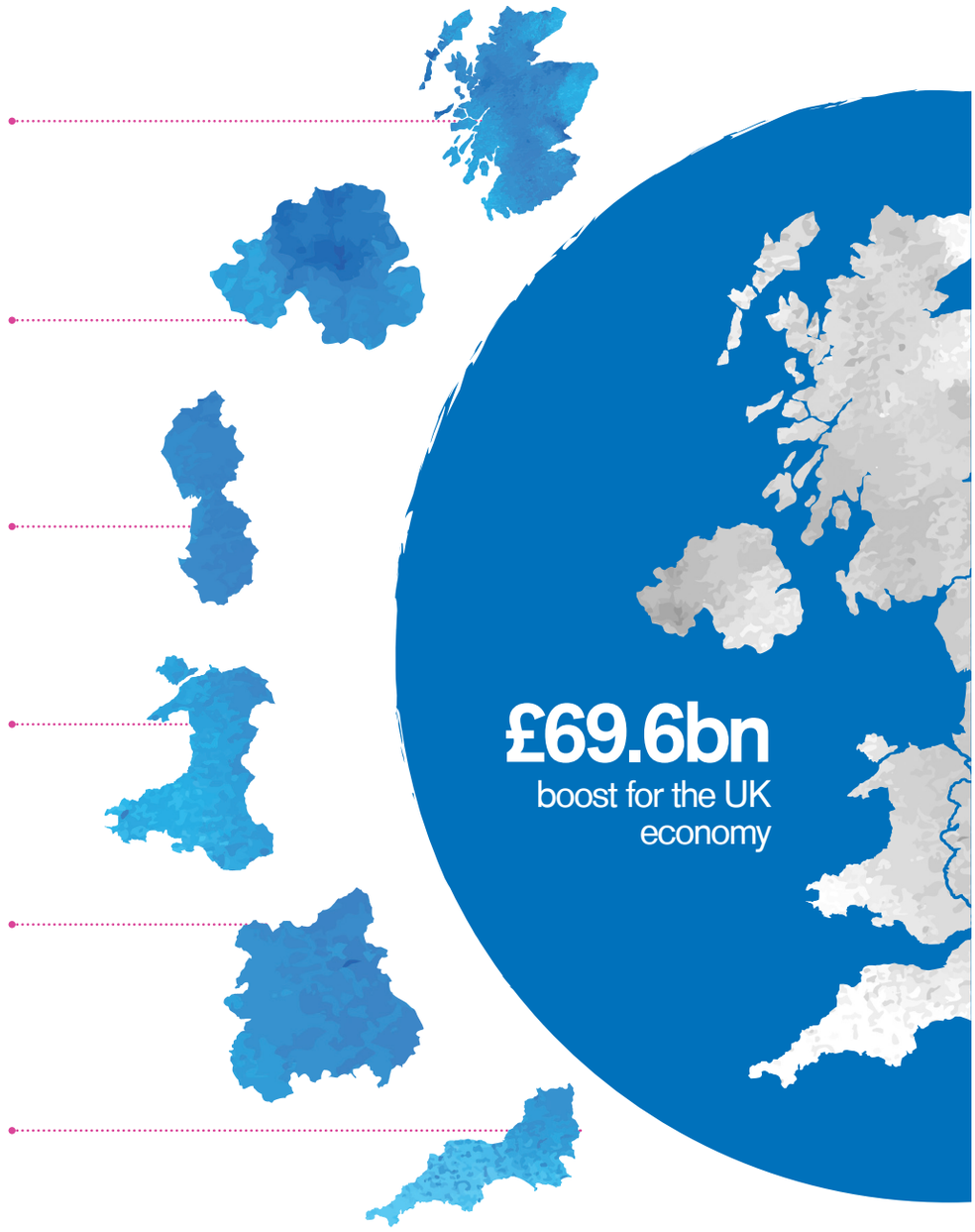
Northern Ireland
£1.60bn boost for the UK economy
10.3% potential productivity increase for small businesses

North West
£6.74bn boost for the UK economy
10.2% potential productivity increase for small businesses

Wales
£2.51bn boost for the UK economy
10.2% potential productivity increase for small businesses

West Midlands
£5.61bn boost for the UK economy
10.2% potential productivity increase for small businesses

South West
£6.29bn boost for the UK economy
10.1% potential productivity increase for small businesses



North East

10.2% potential productivity increase for small businesses

£1.82bn boost for the UK economy

Yorkshire and Humber

10.2% potential productivity increase for small businesses

£5.18bn boost for the UK economy

East Midlands

10.2% potential productivity increase for small businesses

£4.63bn boost for the UK economy

East of England

10.2% potential productivity increase for small businesses

£7.12bn boost for the UK economy

London

10.1% potential productivity increase for small businesses

£12.38bn boost for the UK economy

South East

10.2% potential productivity increase for small businesses

£11.09bn boost for the UK economy

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Local banking for Britain

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