

Development Bank of Wales's response to the National Assembly for Wales Economy, Infrastructure and Skills Committee's consultation on Access to Banking

1. The Development Bank of Wales welcomes the consultation on access to banking and the three themes within this consultation. Changes to financial infrastructure directly impacts businesses to varying degrees, dependent on size and geography. As Wales is on the periphery of the UK's financial centre and is made up of 99% SMEs, the Development Bank of Wales's response to this consultation will focus solely on the implications of access to banking for Welsh SMEs.
2. Before addressing the three themes of the consultation, it is important to highlight that SME data on banking in Wales is not comprehensive and often intermittently published. While this has been a persistent issue, Economic Intelligence Wales¹ is seeking innovative ways in which this can be addressed, starting with the reporting of key SME finance data for Wales in its quarterly reports.

The current position regarding access to banking services in Wales, to include issues relating to financial inclusion and digital inclusion.

Day to Day banking for Welsh SMEs

3. BVA BDRC SME Finance Monitor data shows that in 2018 99% of SMEs in Wales use only 1 Bank/financial institution, with the other 1% using no more than 2 providers. In Wales 88% of SMEs use business current accounts while 11% use their personal current accounts to access banking services, down from 16% in 2017. This 11% is made up of SMEs with less than 10 employees.
4. The Competition & Markets Authority Retail Banking Market Investigation (2016) showed that SME banking is concentrated in the major banks with their market share remaining stable. The Investigation showed that SME banking demographic percentages and behaviours for Wales are reflective of Great Britain figures and it therefore treated England and Wales as a single market.
5. The Investigation found that 97% of business current accounts are held by SMEs with a turnover below £2 million, 13% are held by start-ups and less than 1% have a turnover above £5 million. StatsWales business structure and SME Finance Monitor data suggests that the majority of SMEs in Wales have an average annual turnover of less than £250,000, with this reflecting the number of micro-business in Wales. Turnover levels can affect outcomes in banking services and costs. Key to SME banking is relationship management services. The Competition & Markets Authority Retail Banking Market Investigation found that:

¹ A research collaboration between the Development Bank of Wales, Cardiff Business School and the Office for National Statistics

“... smaller SMEs with turnover below £250,000, this will typically be provided through a call centre and/or business centre; whereas small to medium and larger SMEs (above £500,000) will generally be provided with a relationship manager. However, even then the level of service and support of their relationship manager will typically vary depending on size of SME. As the turnover size of the SME increases, the more likely the SME will receive more personalised support from its relationship manager.”

6. The evidence suggests that the closure of bank branches will affect the relationship management services of Wales' larger SMEs with the majority of SMEs typically using non-branch channels of assistance. However, 2014 Charterhouse Business Banking Survey data suggested that 80% of SMEs had visited a branch counter service over the past year and around a quarter of SMEs (23%) reported that this was their most used method of banking. This priority is reflected in the SME choice of first banking provider.
7. The majority of start-ups (84%) mentioned that branches were important in their choice of business current account, with 84% of those SMEs saying this was because they needed to pay in cash or cheques and 19% needed to meet a relationship manager face to face². Importantly, 54% of start-ups did some searching before opening a bank account, although 36% went straight to their personal current account provider.
8. Data from the 2014 Charterhouse Business Banking Survey suggested that when SME start-ups enter the banking system 58% said that they did not compare other providers and a further 23% did so in a superficial way. The Competition & Markets Authority Retail Banking Market Investigation found that:

“For start-ups that did not compare banks, the most important reasons given for choosing a BCA provider were it being the personal bank (25%), branch location (20%), and free banking (17%). For those that did compare providers, free banking was the most important reason given (39%), followed by attractive charges and fees (12%) and the branch location (12%).

... 28% of start-ups did not consider future fees when choosing their initial BCA. Even though 72% of all start-ups said they considered future fees but only 36% considered and compared future fees.”

9. When it is also considered that larger SMEs are more likely to receive bespoke pricing, the Competition & Markets Authority Retail Banking Market Investigation found that SMEs are not reacting to differences in pricing and quality of services outcomes means the market for these customers is not well functioning, further corroborated by only 4% of SMEs switching bank account providers.
10. This is further supported by the Current Account Switching Service data which showed that 3.38% of those that switched bank providers in 2018 were small businesses and charities. Gross figures for small business and charities switching using the Current Account Switching Service is less than 1% of the SME population.

² Competition & Markets Authority, Retail Banking Market Investigation, 2016.

11. Even after the end of SME's free banking period the majority of SMEs did not consider switching (67%) and around 35% of those who considered their banking service to be poor were still not considering switching but those more likely to switch providers were those with low debit or credit balances³. The data quoted above is not entirely up to date or available specifically for Welsh SMEs and the Development Bank of Wales recommends that this is further investigated.

Access to Banking Finance for Welsh SMEs

12. Of Welsh SMEs that applied for finance in 2018, 87% of applications obtained the facility applied for. Economic Intelligence Wales research shows that the UK banks are still the biggest providers of finance to SMEs in Wales. Furthermore 60% of SMEs with a need for funding actually applied for finance. 34% of those applying went to their main bank, 19% to a new provider, and 10% to another provider they already used. 45% of SMEs were confident that their bank would say yes to a finance application. This confidence varied from 36% of businesses with 0-9 employees to 80% for businesses with 10-249 employees.
13. During 2018 27% of Welsh SMEs had a strong relationship with their bank, feeling they can approach them when they need to. However, 57% felt their relationship with their bank was transactional and the relationship is fine with 16% stating they did not have a working relationship with their bank but wish they had one.
14. SME Finance Monitor data for Wales shows that 44% of Welsh SMEs met the definition of a Permanent non-borrower, 5 percentage points lower than the UK, with smaller SMEs more likely to fit this description. Of the remaining SMEs, 84% were happy non-seekers of finance. The data also highlighted that in 2018, almost all Welsh SMEs held credit balances. The largest group was those who hold less than £5,000 (30%); this has decreased from 32% since 2017. 12% of Welsh SMEs held between £5,000 and £24,999, down from 26% in 2016. Of those who held £10,000 or more in credit balances in Wales 76% said that it reduced their need for external finance.
15. The November 2018 Quarterly Report by Economic Intelligence Wales estimated that the Welsh share of Great Britain's bank lending to SMEs has fluctuated between approximately 4.5% and 4.7% during the last five years and more than half of total loans were to the Cardiff and Swansea postcode areas. While the Welsh share of the value of British loan facilities approved in 2017 was 5%, the second lowest region in Britain, when examining the distribution of bank lending in the UK relative to the business population, Wales, alongside the South West, North East and Scotland, had a higher share of bank lending value and volume⁴.

³ See footnote 2.

⁴ This data is driven from postcode and therefore actual numbers may vary due to businesses with SY postcodes in Wales.

16. Economic Intelligence Wales identified that overdraft facilities are a major source of SME finance in Wales but the value of overdrawn balances was in general decline, falling from £660 million in 2012Q1 to £453 million in 2017Q4, but increased to £489 million in 2018Q1 and then to £535 million in 2018Q2. This recent increase is related to a growth in the value of overdraft facilities approved which has been steadily increasing since 2017Q2, from £46 million to £76 million in 2018 Q2. Overdraft facilities, along with credit cards, are one of the most used from of finance (35%) by those that export, supply exporters and export considerers⁵.

The variety of ways in which branch closures and access to free ATMs can affect local communities

Branch closures

17. Clearly, access to banking is essential for SMEs as the main source of finance. The Development Bank of Wales recommends that a review of access to banking should consider the lending levels of banks in areas where branches have closed, which has been highlighted by research and also by organisations such as FSB, but the data suggests that lending to Welsh SMEs is not decreasing.
18. Recent Economic Intelligence Wales research into equity investment in Wales highlights the importance of proximity in making investments in SMEs⁶. Spatial proximity between investors and investees affects the quality of communication as investors in regional economies use their presence in a locality to generate tacit-knowledge and face-to-face contact to create networks which are used to inform due diligence on a customer and an investment.
19. The major banks are crucial co-investors for the Development Ban of Wales for its investments across the whole of Wales. Due to its investment model and pan-Wales coverage, the Development Bank of Wales will continue to require the banks to co-invest in Welsh SMEs and as highlighted by the Economic Intelligence Wales research, plays an important brokerage role in bringing together SMEs and (other equity) investors⁷. Development Bank of Wales can therefore assist in providing the tacit-knowledge and network required to provide finance in the regional economies of Wales.
20. As branches continue to scale back the relationship management services and assistance they provide to SMEs, which is core to SMEs choosing their bank, more will be delivered through their digital channels. The recent investment in internet infrastructure has improved Welsh SME access to superfast broadband and it is estimated that total sales for SMEs in Wales attributable to broadband adoption could be almost £229m, of which £124m (54%) is derived from superfast broadband-enabled services alone⁸.

⁵ Economic Intelligence Wales, Export Finance in Wales, 2019.

⁶ Economic Intelligence Wales, Equity Clusters in Wales, 2019.

⁷ See footnote 5.

⁸ Wales Economic Research Unit, Economic Impact Report for Wales, 2017.

21. This shows that Wales has the infrastructure to assist its businesses to use digital banking channels. Although there is little data currently publically available on SME digital banking behaviour, according to the 2017 Financial Lives Survey on personal retail banking behaviour by the FCA, the use of more modern methods of banking such as video link banking, biometric authentication in Wales has not yet been discernibly adopted but 46% of Welsh respondents have used a self-service machine, 15% have used a mobile wallet and 24% of these have used it at least once a week.

Access to Free ATMs

22. The Development Bank of Wales recommends that the National Assembly for Wales Economy, Infrastructure and Skills Committee, as part of its consultation on access to banking in Wales, when looking at access to cash, refer to the March 2019 Access to Cash Review report. The Access to Cash Review report is a comprehensive view on the use and distribution of cash in the UK.

23. The UK's ATM network shrank by almost 5% in the second half of 2018. In March 2019 there was a loss to the free cash point network of around 2.5% in a single month⁹. Ten years ago, six out of every ten transactions were cash, now it's three in ten and in fifteen years' time, it could be as low as one in ten¹⁰. This on-going trend is assumed to accelerate as the value of retail purchases made by card now accounts for more than three quarters of all retail sales, according to the BRC's latest annual Payments Survey released in September 2018, with cash accounting for just 22% of all retail sales.

24. It is important to analyse the driving factors for the reduction in cash. Cash acceptance by merchants and retailers is more likely to drive the decline of cash than issues around cash access as the costs of handling and banking cash on the business had increased; the increase in cost is driven itself by the cost of distributing cash (£5 billion a year)¹¹. As Wales has an economic share of 5%, Wales' share of this cost is £250 million a year.

25. The Access to Cash Review recommended that:

“... innovation is overtly sought by regulators in the field of SME cash deposits to improve access to local cash deposit facilities. Deposit-taking ATMs offer potential to widen deposit routes, but would require regulator support. We also recommend that the Post Office examines its SME deposit facilities and improves them, automating them where it is cost-effective to do so.”

26. The Review went on to state that access to cash is an infrastructure issue, not just access to ATMs, and is linked to consumer behaviour in other sectors that may require legislation. This legislation would build a cash distribution infrastructure on a utility model, guaranteeing access through Local Authorities, deposit taking ATMs and smart safes to encourage cash banking and ensure the vulnerable in society are not left behind. The vulnerable are not just the individual but also the businesses whose customer base uses cash but they are unable to operate in a cashless financial system.

⁹ Which?, Thousands of cash machines vanish: 'I could lose my independence', 2019.

¹⁰ UK Finance, UK Payment Market Report 2018.

¹¹ Access to Cash Review, Final Report, 2019.

27. Recommendations for intervention to safeguard the small businesses that cannot immediately transfer to a cashless financial system has been previously called for by the 2016 Locked Out: The impact of bank branch closures on small businesses report by FSB. Like the Access to Cash Review, FSB also highlighted that role for the Post Office in SME cash deposits.
28. The 2018 SME Finance Monitor data for Wales highlights that 19% were aware of their bank's arrangements with the Post Office and using their business banking service, 51% were aware but did not use the service, and 30% were not aware of the service. Awareness of this service is higher amongst SMEs with less than 10 employees but usage of the service was higher for SMEs with more than 10 employees.
29. Welsh SMEs will continue to react to the increasing costs of trading in cash and the behaviours of their customers. The Development Bank of Wales sees a clear role for some kind of intervention to support the SMEs that are unable to adapt quickly to the financial system going cashless. Supporting Welsh SMEs to continue trading in cash may also assist vulnerable people in Wales through the change.

To understand the potential process, benefits and challenges involved with establishing a community bank with multiple branches in Wales.

30. A Community Bank will need to be built on a high quality and very detailed business case. This will be essential as it will need to obtain a banking licence from the Prudential Regulation Authority (PRA). Clearly the operating costs of the Bank will increase as the number of branches increases so it will be important that the optimum number and type of branches together with the phasing of their opening are assessed in the business case.
31. The PRA, alongside the Finance Conduct Authority (FCA) have produced a very helpful guide entitled 'New Bank Start-up Unit, What you need to know from the UK's financial regulators'¹².
32. The Development Bank of Wales is working with the Welsh Government to provide market intelligence, through Economic Intelligence Wales, and support as they consider options for a Community Bank.

¹² Prudential Regulation Authority & Financial Conduct Authority, "New Bank Start-up Unit, What you need to know from the UK's financial regulators". Available here: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/new-bank/new-bank-start-up-unit-guide.pdf?la=en&hash=1CE8592195229B04C81AA18E82887A851A099ABB>