Scale up to level up

Reforming SME Finance

A WPI Economics Report for the All-Party Parliamentary Group (APPG) on Fair Business Banking

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07/09/21

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About this report

This report presents findings from research conducted for the APPG's inquiry into SME access to finance, highlighting the limitations of the UK system of finance for SMEs, key issues faced by SMEs and alternative finance providers as a result of the current system and the broader impacts this has on the UK and regional economies. We present a package of recommendations for short- and longer-term implementation to help close the SME finance gap. As well as considering existing research, the APPG held four evidence sessions with a range of stakeholders, including industry professionals, academics and representative bodies for SMEs, businesses and finance providers, who also contributed written evidence.

About WPI Economics

WPI Economics is an economics and public policy consultancy. We are driven by a desire to make a difference, both through the work we undertake and by taking our responsibilities as a business seriously. We provide a range of public, private and charitable clients with research, economic analysis and advice to influence and deliver better outcomes through improved public policy design and delivery.

About the APPG for Fair Business Banking

The APPG is a cross-party group with members from the House of Commons and the House of Lords which puts forward policy recommendations to Government that encourage a finance system which allows enterprise to flourish and business to thrive. The Group acts as a forum and focal point for the SME community and financial services industry to deliver reforms in their long-term interest.

About the Authors

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Joe is an experienced policy professional. Before joining WPI Economics, he spent the past five years working in a range of roles at the Association of British Insurers – most recently as a Senior Policy Adviser in the general insurance team. During his time at the ABI, Joe led on policy development and Government engagement across a range of areas including cyber risk, work and health, and civil justice reform. Prior to the ABI, Joe worked in the communications team at the New Schools Network and before that, in the office of Andrew Jones MP.

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Alongside her role at WPI Economics, Christina completed an MSc in International Public Policy at UCL, where she was also a research assistant to a Professor in Public Policy. Prior to this, she worked in policy and research in the charity sector with a focus on young people, education and radicalisation. During her Portuguese and French BA at King's College London, Christina participated in a study abroad programme, spending a semester at the Institute d'Etudes Politiques in Lyon followed by six months at the Federal University of Rio de Janeiro.

Acknowledgements

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- Kevin Hollinrake MP, Conservative
- Lord Holmes, Conservative
- Peter Dowd MP, Labour
- Lord Sharkey, Liberal Democrat
- Sarah Olney MP, Liberal Democrat
- Alison Thewliss MP, SNP
- Tonia Antoniazzi MP, Labour
- Ben Lake MP, Plaid Cymru

We would like to thank Iwoca for their co-sponsorship of the inquiry.

We would like to express our sincere thanks to those who offered their time and insights for this report through our inquiry evidence sessions and written submissions. Witnesses of the inquiry are named below.

Witnesses

- **Diana Chrouch**, BAME Policy Chair, Federation of Small Business
- **Martin McTague**, Policy and Advocacy Chair, Federation of Small Business
- **Dr Roger Barker**, Director of Policy & Governance, Institute of Directors
- **Professor Colin Mayer CBE FBA**, Saïd Business School, Oxford University
- **Richard Jeffery**, National Director, GC Business, The Growth Company
- **Tony Greenham**, Director at the Mutual Banks Association
- **Theo Hadjimichael**, Chief Executive Officer, Responsible Finance
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- **Jessica Levy**, Director of Communications, Federation of Master Builders
- **David Sheen,** Public Affairs Director, UK Hospitality
- **Professor Harry Schmidt,** Goethe University, Frankfurt
- **Dr Ulrich Schüwer,** Goethe University, Frankfurt

We would also like to extend our thanks to Ali Shalchi at the House of Commons Library for coordinating our research with international parliaments, the Bundestag and US Congress for their evidence submissions.

Foreword by Kevin Hollinrake MP, Co-chair of the APPG on Fair Business Banking

It is an old adage that banks will lend you an umbrella in fair weather and ask for it back again when it begins to rain. Sadly, despite the commonly accepted importance of SMEs to our economy and the very basis of our free market system, this is too often the case in practise. During the critical post-recession period of 2008 to 2013, total bank lending to non-financial businesses in the UK dropped by around 25%, during the same period in Germany, lending by the thousands of regional mutual banks (Sparkassen) and co-operatives increased by around 20%. Similar dynamics were in evidence in the US, Switzerland and Japan, all of whom have effective and established not-for-profit banking sectors. In fact, the UK is unique in the G7 in having no such sector presence.

This excellent report, distilled from significant input and evidence from a wide range of stakeholders (including international and domestic academics, high street and challenger banks, non-bank lenders, fintechs, regulators, HM Treasury and BEIS ministers and officials, the British Business Bank, business representative groups and many others to whom we are very grateful) makes the case for a completely new approach. The report also references a number of key experts, including Mark Carney and the Chancellor, Rishi Sunak, who have also pointed out the UK funding gap and its negative economic consequences.

The provision of SME finance in the UK is hugely concentrated and largely shared amongst the Big 4 banks, all of whom are primarily responsible to their shareholders. Understandably, at times of crisis the commercial imperatives of the banks themselves is the overriding concern, often at the expense of their customers, however loyal or competent they are. Where there is no profit imperative, such as in a mutual bank, there is no reason to pull the plug on a business that will return to profit shortly after a crisis ends.

We have seen and heard clear evidence that, in general, 'big banks lend to big businesses'. As a result of the consolidation of UK banks over many decades, this has led to a critical shortage of finance to many SMEs and also a lack of trust between banks and businesses which has significantly reduced the borrowing appetite amongst SMEs. A significant proportion (73%) of SMEs would rather grow more slowly than borrow, which is clearly bad for the business itself, for the jobs that could be created and, when multiplied millions of times, for UK plc. This lack of finance is a particular barrier to the government's ambition to level up as availability is less of a problem in prosperous area such as London and the South East.

The good news is that the solutions are within our gift; removing regulatory and competition barriers for challenger banks, mutuals and Community Development Finance Institutions, providing pump-prime funding from big banks and dormant assets, giving non-bank lenders access to cheap money to lend from the Bank of England's Term Funding Scheme for SMEs, rolling out Legal Entity Identifiers to make it easier for big banks to lend to small businesses, better signposting and a new approach to equity finance through a 3i 2.0 and regional angel programmes are amongst a number of key recommendations in our policy paper.

Executive Summary

The UK is the most regionally imbalanced country in Europe when it comes to the productivity of its economies,[i] and consequently the job opportunities and livelihoods of many of its citizens depending on where they live. The Prime Minister has made addressing this disparity one of the key missions of his administration. The focus of this inquiry by the All-Party Parliamentary Group on Fair Business Banking is the role that the availability of finance to small and medium sized enterprises (SMEs) can play in this vision of levelling up the UK.

In a speech at Mansion House in 2019, Mark Carney highlighted the £22 billion funding gap faced by SMEs, the backbone of the UK economy.[ii] The evidence heard by the inquiry paints a stark picture of the impact of this gap, with SMEs and their representatives reporting significant problems in accessing finance. This runs across the full spectrum of the various services that banks provide to firms, but there is a particular problem in relation to working capital to allow businesses to grow. We have heard that this problem is particularly acute for the very smallest and newest firms, companies run by Black and Minority Ethnic (BAME) individuals, sectors such as building and hospitality, and businesses based outside of London and the South East.

Supporting smaller companies – who comprise 99% of firms and are the forefront of enterprise and innovation – to grow has to be a central question of strengthening our regional economies. Currently, fast growing businesses in the country are concentrated in London and the South East,[iii] as noted by Andy Haldane and others. A relative lack of access to working growth capital has been highlighted as a central cause of this by experts the inquiry spoke to such as Colin Mayer, and we know that just over half of business angels are based in London or the South East.[iv]

Ultimately, the broad view we have heard from the inquiry is that the UK's current financial system – which has historically been dominated by four large shareholder driven banks – is not fit for purpose in helping to address this question. The Chancellor of the Exchequer himself has in the past highlighted that the 'limp competition' in the banking sector at present is contributing to a lack of credit availability for smaller firms.[v]

In order to level up the country as we recover from the pandemic and improve the overall competitiveness of UK PLC, a more diverse and competitive supply of finance is needed. This includes strengthening and supporting the UK's thriving FinTech and non-bank lending sector to compete with the big banks, particularly as the Big Four have strengthened their share of the market during the pandemic.[vi] It also means encouraging greater provision of models of finance which adopt a patient capital approach to their investments, such as regional mutual banks, which are a major feature of SME finance provision in all other G7 nations, and Community Development Finance Institutions (CDFIs). These models are not shareholder driven, and therefore operate a fundamentally different business model from the current models dominating UK SME finance. In addition, along with challenger banks, they employ a relationship-focused approach making them well-placed to understand their SME customers' finance needs.

There are exciting developments in this regard across various types of products and institutions – which all have a part to play – and the right policy and regulatory framework is needed to maximise the opportunities that these pose. The APPG has considered extensive evidence from expert witnesses, academic research, and experiences internationally. We have determined that changing SME finance to deliver levelling up will not happen as a result of a single policy, but through a coherent strategy based on a holistic assessment of how finance needs to be transformed in order to level up the country. This strategy should be set out the by the Government in the Levelling Up White paper, and it needs to:

1. **Deliver a strong local finance option for every business in the UK** – by providing capital to regionally based CDFIs and mutual banks which they will then multiply by lending to thousands of local businesses, and also ensuring that mutuals can share resources in order to allow them to scale, as already happens in other jurisdictions. In the longer term, a mandated portion of bank lending should come through CDFIs in order to allow them scale their offerings further.
2. **Turbocharge the challenger bank and non-bank lending sector** – these companies have provided welcome challenge to the Big Four banks since the crisis, however they are hamstrung by regulation which needs to be urgently addressed, including through reform to the minimum requirement for own funds and eligible liabilities (MREL) rules and access to the Term Funding Scheme for non-bank lenders.
3. **Unlock patient capital for growing companies** – the Government should build on its welcome initiatives on unlocking patient capital from pensions funds and should copy an approach taken in France where a social usefulness criterion is used to unlock money for investment in long term, socially important companies.
4. **Ease the finance application process to encourage borrowing for growth** – by ensuring that business support services – such as through Local Enterprise Partnerships – are properly funded and the Bank of England continues to promote the use of Legal Entity Identifiers.

Chapter One: Setting the scene – issues in SME finance

Small and Medium sized Enterprises (SMEs) are a crucial element of the British economy, accounting for around three-fifths of the UK's private sector employment at the start of 2020, as well as half of its turnover.[vii] They also make up 99% of all businesses, and three quarters of all firms in the UK employ no one except the owner.[viii] This section of the UK business population has also been badly hit by the Covid crisis, with two-thirds of SMEs reporting a reduction in sales of 50% or more due to the pandemic, with smaller SMEs reporting the greatest impacts and simultaneously being those least likely to have resources to support them through it.[ix]

As well as being a vital element of the economy in and of themselves, many SMEs that exist today are also the large firms of the future and there is substantial evidence that very high growth firms make a major contribution to a nation's employment growth[x] and wealth.[xi] Having the right conditions in place to support growth firms ought to be a major preoccupation of policymakers – and access to finance is one important element of this. Chapter 2 considers the wider consequences of SME access to finance in greater detail.

SME Finance in the UK

Existing research raises a number of important characteristics in relation to the UK financial system. These are:

Feature of the UK banking system	Description
Concentration	SME banking in the UK has been characterised as a four-firm oligopoly in the past, with CMA finding in 2015 that the big four banks accounted for approximately 80% of all lending to SMEs in the UK.[xii] Recently we have seen some challenge to this from FinTechs, with the share of the big four banks dropping significantly since the financial crisis, before rebounding during the pandemic.[xiii]
Centralisation	Banks can be characterised as centralised or decentralised based on the distance between different agents of the bank, the physical or geographic distance between the various banking establishments, and – crucially – the functional distance between a bank's customers and where decisions in relation to those customers are made. Based on this, the major UK banks can be considered highly centralised institutions.[xiv]
Non-relationship based	As a consequence of this centralisation, the financial system in the UK does not in the main rely on the development of relationships between banks and their customers which allow for long term two-way exchanges of information. This means that the UK banks and the customers miss out on the benefits that arise from this such as the building of trust and creation of high-quality information and data on which to make better financial and business decisions. [xv]

The evidence that we've heard from this inquiry demonstrates that these characteristics of the financial system have led to a number of problematic consequences for customers across a range of areas, which have been brought into sharp relief as a consequence of the Covid pandemic. These are considered below:

Suboptimal experience for customers

Suboptimal customer experience for SMEs dealing with banks for finance is evidenced by low levels of customer satisfaction among SMEs; few customers would recommend their bank to a friend,[xvi] and a significant proportion of SMEs do not feel they get sufficient information from their bank to make decisions on products.[xvii] The decline in relationship-based banking and the resulting disconnect between banks and borrowers has been highlighted as a particular problem in existing research and in evidence sessions for this report.

Experts expressed during evidence sessions that what is in place to address relationship between customer and bank does not offer enough support; relationship managers have very high client loads (reportedly up to 3000 clients each, as heard by the inquiry) and closures of local branches have substantial implications for face-to-face support, especially for start-ups needing a greater level of advice and expert input.

Evidence presented to the inquiry described how some SME customers are excluded from accessing this support from the outset because they are being denied business bank accounts, presented as a particular issue for BAME business owners. This posed an acute problem when businesses sought financial support for their businesses from the Government, and research by BVA-BDRC shows that Black-led SMEs and Mixed race-led SMEs were more likely to use personal bank accounts than the all-SME average; 33% and 29% respectively, compared with an 18% average.[xviii]

Unnavigable finance landscape and burdensome applications processes

Our engagement with experts raised problems SMEs face in navigating the process of obtaining finance for their business, with small businesses spending disproportionate resource on the process. This problem is echoed when shopping around for different providers or types of finance; one in four SMEs is put off from shopping around for finance by the hassle or time taken.[xix] Customers appear to have a limited understanding of the differences between available products which has clear consequences for the customer experience and ability to utilise the best finance option for their needs. Furthermore, this lack of shopping around leads to a lack of demand side pressure against incumbent providers, creating a feedback loop which reduces the competitiveness of the supply of finance to SMEs.[xx]

*"**The customer journey is tortuous and poorly signposted – making information available is not beyond the wit of the banking industry"** – Diana Chrouch, BAME Policy Chair and Special Advisor to the APPG for BAME Business Owners*

The inquiry heard evidence that suggests that providers are not alleviating this complexity where they could, for example, through offering more and better information for SMEs, or enough clarity surrounding terms of finance. Over one in five SMEs feel that providers do not give them adequate information about their products for SMEs to evaluate whether the products meet their needs.[xxi] This was echoed in oral evidence from expert witnesses, where we heard that a lack of transparency formed part of the reason for limited understanding of different finance options for SMEs, who as a result find it difficult to compare terms of bank finance (for example, on aspects such as secondary charges, bespoke interest rates agreements and customisation of products).

"Virtually everybody ends up dealing with the current oligopoly and that means their borrowing is largely restricted to overdrafts and loans" *- Martin McTague, Federation of Small Business Policy and Advocacy Chair*

This lack of information does not just impact prospective finance applicants, but also those who do seek finance; evidence from various stakeholders highlighted that many businesses are not given feedback to explain why their application for finance was rejected, as banks are not obliged to explain the reason for their decision. On an individual level, knowing the reasons for rejection could help SMEs be more successful in future applications, or prevent them from being discouraged from seeking finance again at all. According to the BBB's 2019 Business Finance survey, over a third of SMEs who were not offered all the finance that they applied for gave up or put their plans for finance on hold.[xxii] Furthermore, the inquiry heard that the Bank Referral Scheme – through which banks which reject SMEs for a loan are obliged to refer eligible SMEs to Government-designated finance platforms – has had limited success in addressing challenges SMEs face in accessing finance.[xxiii] On a broader market / policy perspective, a lack of data on reasons for rejections also poses problems for understanding systemic issues in access to finance, particularly with regards to minority-led businesses. This point about data was stressed in evidence presented to the inquiry; data is not captured on BAME businesses seeking finance, hindering attempts to identify and quantify the extent of the problem. This is in spite of previous calls for this data to be captured, as acknowledged in then-DCLG's 2013 report *Ethnic Minority Businesses and Access to Finance* for example.[xxiv]

"There is a time pressure on small businesses – they rely on where they have always been able to get finance, then one day they're rejected, and business owners don't have the headspace or time to explore alternatives" *– Jessica Levy, Director of Communications at the Federation of Master Builders*

Negative perceptions of the market and a lack of trust towards financial institutions

Negative perceptions of the market and its providers for are held by a considerable number of small businesses. A joint study by the FCA and CMA found that just 13% of SMEs trust their bank to act in their best interest, and only a quarter felt their bank supported their business. [xxv] The inquiry heard evidence that smaller SMEs in particular feel uncomfortable approaching large banks for loans because they do not trust them.[xxvi]

SME trust towards large banks is a key theme in the Treasury Committee's SME Finance report, which discusses high profile past misconduct and mistreatment of SMEs by financial institutions and how this is prevalent in consumer consciousness, contributing to weak demand from SMEs.[xxvii] This links into what the Treasury Committee has dubbed the "perception gap", where SMEs are discouraged from seeking finance.[xxviii] Perhaps most damagingly, research shows that 73% of SMEs would rather grow more slowly than borrow to grow more quickly.[xxix]

Though estimates of the overall rate of businesses 'discouraged' from applying for finance vary (the Social Market Foundation found that some studies estimate one in ten SMEs are 'discouraged', while others estimate this to be closer to one in twenty),[xxx] there is ample evidence that discouragement is a key issue for businesses who would otherwise access finance. The problem is particularly acute for BAME-led businesses; the APPG for BAME Business Owners conducted research to gather the direct experiences and concerns of BAME-led businesses over the course of the pandemic, with discouragement and a lack of trust and confidence in financial institutions being key themes of the findings. In addition, a recent survey by the British Business Bank (hereafter BBB Entrepreneurship and Diversity Survey) found that discouragement was found to be significantly higher among BAME business owners compared to White counterparts, and that among Black African business owners it was 10 times the level among White counterparts.[xxxi]

There is also evidence of a broader sense of pessimism towards access to finance across existing research and expert views expressed in evidence sessions. A survey by the Federation of Small Businesses found that 42% of small business owners believe credit availability is poor or quite poor, while just 24% believe it is readily available.[xxxii] Business' apprehension leads to real consequences for business growth; three in ten businesses did not apply for finance in 2020 due to fear of rejection, according to the BBB SME Finance Survey; for over one in ten, it was the principal reason for not applying for finance.[xxxiii] Clearly a problem for SME businesses across the board, the issue is nevertheless even greater among BAME-led businesses, as highlighted in evidence to this inquiry. This issue is especially pertinent in light of financial assistance launched to mitigate the impacts of the pandemic on businesses; the APPG for BAME Business Owners' research found that an established lack of confidence and trust in official funding sources led many business owners not to apply for covid-related business assistance.[xxxiv] The BBB Entrepreneurship and Diversity Survey found that nearly 40% of Black entrepreneurs and nearly 50% of Asian and Other Ethnic Minority entrepreneurs gave access to finance as the reason for stopping working on their business idea, compared with 25% of White respondents, and led to a considerable share of Black business owners to close their business.[xxxv] These barriers are long-standing; a 2007 survey found that Black business owners were significantly more likely to feel discouraged from applying from finance than other ethnic groups.[xxxvi]

SMEs have been given reason to feel discouraged. A survey conducted by the FSB in 2018 found that new credit was 'unaffordable' for a third of small businesses,[xxxvii] and a study cited by UK Finance estimated that the number of creditworthy firms which were either declined for credit or discouraged from applying was around 70,000, amounting to around £2 billion of debt.[xxxviii] As highlighted to us by witnesses to this inquiry, BAME businesses are disproportionately impacted by these problems, and have been for a long time; data cited in a 2008 Runnymede report demonstrated that Black-led businesses were disproportionately more likely to be rejected for loans, and where business finance was agreed, the difference between amount sought and amount agreed was significantly greater from Black African- and Pakistani-owned businesses.[xxxix] These barriers have been exacerbated by the pandemic, as found by the APPG for BAME Business Owners' research. A poll conducted as part of their listening exercise on the impacts of the pandemic on BAME business owners showed that the majority – 68% of respondents – were unable to access any of the Covid support measures put in place by Government.[xl]

"Banks have reached the limits of their appetite for lending to SMEs" – *Dr Roger Barker, Institute of Directors*

These issues push some SMEs to seek out other forms of finance which, other than being more accessible to them, may not be the best option in terms of cost or protections: we heard in our enquiries that businesses use payday loans or loans from friends / family, because there is a high probability they will be accepted for / acquire the loan.

Chapter Two: Impacts of the current gaps

As well as the issues that are caused for businesses themselves, these widely reported issues with how the banking sector serves SMEs also have wider knock-on effects for economy and society. The evidence heard by the inquiry helps to demonstrate how addressing these issues could improve the UK's overall competitiveness, level up the regions of the UK, and support greater business and economic resilience.

Making the UK the best place to scale up a business

"There is clearly a need for policy intervention – agile entrepreneurs are being denied finance" – *Diana Chrouch, BAME Policy Chair and Special Advisor to the APPG for BAME Business Owners*

It is a statement often made in economic policy that the UK is good at start-ups, but not scale ups. Quantifying this, the Chancellor of the Exchequer Rishi Sunak has in the past highlighted that the UK finishes 13th out of the 14 OECD countries in the proportion of start-up businesses that grow to 10 people or more in three years.[xli] This matters more widely – fast growing businesses have been highlighted by a number of policy experts and organisations as being central to the UK's economic prospects in terms of employment growth, productivity, and competitiveness. For example:

- Lord Sainsbury's book *Windows of Opportunity* built on his experience at the heart of economic policy making to examine the factors which contribute to a nation's overall economic success, and found that investment in a relatively small number of 'high value added' fast growing firms was central to the economic competitiveness of nations.
- A piece of research by Nesta looked at the role that the 6% of the fast-growing firms played in the UK economy, showing that these firms had contributed to almost half of employment growth in the late 2000s.[xlii]
- A report written by Sherry Coutu CBE for the Coalition Government in 2014 found that a 1% increase in the number of scale up companies in the UK could create 238,000 jobs and £38 billion GVA in 3 years.[xliii]

As a result, supporting a better scale up environment in the UK has been a key preoccupation of economic policy makers. This objective sits beneath the current Government's Plan for Growth, as well as the previous Industrial Strategy, and various initiatives are delivered by the British Business Bank (BBB) , British Patient Capital, Local Enterprise Partnerships, Innovate UK and the Catapult network.

A golden thread running through efforts to support a scale up environment is improving the availability of patient, or long term, capital to allow businesses to finance long term growth. Individual current and past initiatives have made a substantial contribution towards improving the availability of patient capital, such as the Future Fund and subsequent programmes.[xliv]

However, the inquiry has heard that the very nature of the UK's financial system prevents the embedding of a patient capital approach. The dominant financial players in the UK banking sector rely on a short-term shareholder driven model, which is highly centralised and not conducive to long term relationships will allow the building of understanding between businesses and customers, during which patient investments can bear fruit. We also know from the evidence heard by the inquiry that the current model is responsible for a basic lack of trust in banks on behalf of businesses.

Policies that support challengers to this model can allow for the development of a more consistent patient capital approach.

Levelling up and regional growth

"Unquestionably we have got a problem of regional inequality of SME funding, a long-standing problem" *– Professor Colin Mayer CBE FBA, Saïd Business School, University of Oxford*

The UK has one of the most regionally unequal economies and societies in the G7. As the Prime Minister said in his speech on levelling up in July "Everyone knows that talent and energy and enthusiasm and flair are evenly spread across the UK…it is opportunity that is not".[xlv] The evidence heard by the inquiry suggests this is specifically the case in regard to small business finance.

The primary discourse surrounding policy and levelling up has been around, among other things, infrastructure spending, the location of civil service offices, and Government spending on R&D. However, the unequal availability of private finance by smaller firms in different parts of the country, and policies to address this, are a relatively overlooked aspect of this equation. Accessing finance – particularly working capital – is essential in allowing businesses to grow, and we know that innovative firms create spill-over benefits that are largely retained in a local area.[xlvi]

In the past, the UK has relied on local banking systems with close, established relationships between local shareholders, local banks and businesses.[xlvii] This provided many benefits, including facilitating the sharing of customer specific, proprietary information – high quality information gathered through multiple interactions between customer and bank over time, over different products. For various reasons, including economies of scale, and banks wishing to diversify their activities post-Financial Crisis, the UK has moved towards a highly centralised banking sector.[xlviii]

This centralised system contributes to a lack of availability of this type of finance outside London and the South East, particularly equity finance. Controlling for a range of variables (e.g. firm size, industry), the probability of a firm getting equity funding is up to 50% lower in nearly all regions outside of London.[xlix]

As discussed by Professor Colin Mayer in research shared with the inquiry:

The spatial skew in the allocation of finance has been compounded by the extreme, and internationally exceptional, spatial concentration of Britain's finance industry in London. Given the need of venture capital for localized tacit knowledge, this has created a 'liability of distance' problem in access to finance. It is thus consequential both for slowing the pace of post-COVID recovery and impeding regional convergence.[l]

The centralisation of the UK's finance industry perpetuates the centralisation of its economic growth in London and the South East. There has been good work by Government to look to bridge the gap in the availability of finance more broadly; the BBB Regional Angels programme was highlighted to us as a good example by business representative bodies. However, it is worth considering how a broader range of financial provision could help to deliver a more decentralised, relationship-based model of banking which has in other countries, such as Germany, contributed to a greater regional economic convergence.

Resilience

One of the primary functions of the financial system is to allow firms and households to protect themselves against economic shocks. This is particularly important when these shocks are systemic, as helping firms to protect their balance sheets and absorb losses also helps to protect the economy as a whole, and allows it to bounce back from crises effectively. In a survey of small businesses by the British Chambers of Commerce with Funding Circle, 44% of respondents felt that access to finance would help them overcome remaining barriers faced as a result of the pandemic.[li]

It has been well documented by business owners at the time how banks withdrew credit lines from businesses in the aftermath for the financial crash,[lii] precipitating their move away from SME lending over time. In contrast, countries with a far more relationship-based model of banking such as Germany were actually able to increase lending to SMEs during that period. [liii]In relation to other crises, academic research has shown that counties in the US with relatively higher shares of local and independent banks has the most positive economic effects in the aftermath of natural catastrophes.[liv]

Strengthening the role played by more relationship-based model of banking and finance is therefore crucial in terms of improving the resilience of UK businesses, the economy and communities across the country as consequence.

Chapter Three: Alternative models and providers

The evidence for a problem in relation to access to SME finance is strong. The current UK model creates well documented issues for firms themselves, as well as the wider economy. There is a need to consider alternative models and providers that can provide additional challenge to dominant models of provision. Our inquiry also considered the types of models and providers that could provide this challenge and considered evidence from abroad where similar models were more effective.

Community Development Finance Institutions (CDFIs)

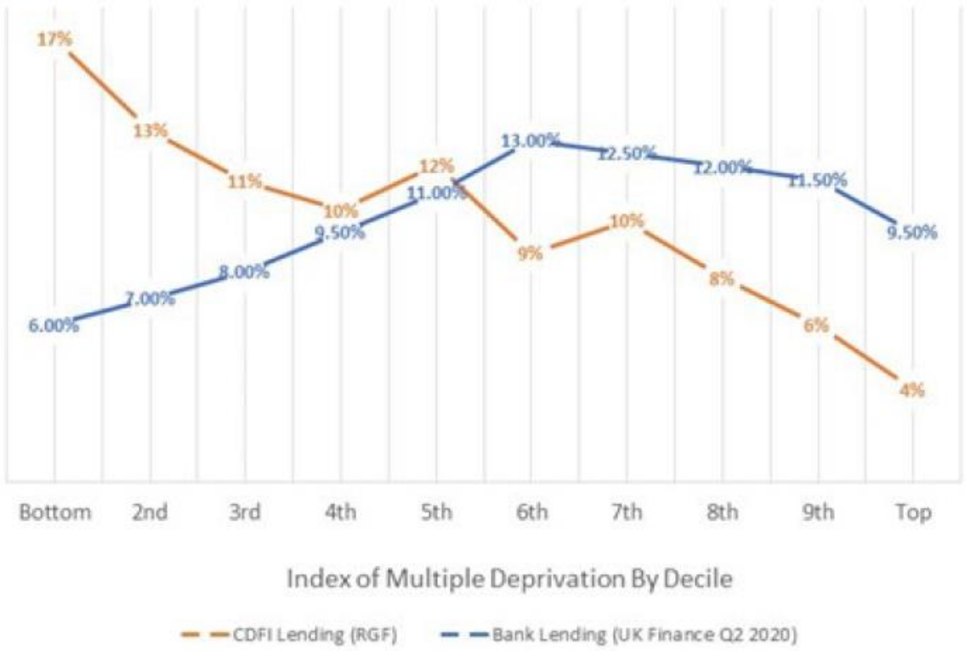
Numbering around 50 in the UK,[lv] CDFIs are financial institutions which provide alternative finance for businesses excluded from mainstream lenders, with a focus on improving economic opportunity in disadvantaged communities. Their core market consists of viable small and micro-businesses which, for reasons of size, lack of a track record for credit, or a lack of security, cannot access all or part of the finance they require to grow.[lvi] CDFIs have been around for about 20 years, and since the 2009 recession, they have lent over £1 billion to communities.[lvii]

CDFIs do not typically take deposits and instead secure capital for their activities from a range of sources, including Government grants, investments and loans from external providers. As CDFIs are not profit distributing or shareholder-driven they can give greater consideration to the wider socio-economic context of a loan and recycle finance and interest into providing more loans for customers.

It has been stressed in evidence presented to the inquiry that CDFIs do not simply serve customers who would otherwise access finance from a bank or other lender, or in other words, competing for customers. Instead, they increase the overall share of customers accessing finance, by focusing their efforts on segments which mainstream banks find costly to assess for risk.[lviii]

CDFIs already address specific gaps identified in the business finance market; 90% of businesses which CDFIs lend to have been rejected for finance by a bank,[lix] and they lend disproportionately more to typically underserved groups, such as BAME-led and women-led businesses and in areas of higher deprivation; 26% of CDFI funding went to women-led SMEs in 2020, while 10% went to minority-ethnic group-led SMEs (the share of these businesses of all UK SMEs is 15% and 5% respectively).[lx] Through the Regional Growth Fund Programme, 87% of CDFI lending was to regions other than London and the South East (compared with 62% of all SME lending in the UK).[lxi]

Figure 1: Comparison of CDFI and Bank SME lending by area of multiple deprivation



Source: Written submission from Responsible Finance

In addition, they serve higher-risk segments of the market, with the impact of this being higher costs for customers going to a CDFI for finance; CDFI finance is nonetheless a lower cost option than other forms of funding, such as personal or business credit cards and overdrafts (12% as opposed to 20-30%).[lxii] Evidence presented to the inquiry highlighted that catering to these higher-risk customers is a risk CDFIs are willing to take for the benefits they can provide in doing so, and to support viable businesses to grow.

Case study 1: Labfacility

The SME Labfacility is the UK's leading manufacturer of temperature sensors, employing 80 people and manufacturing over a million products a year (spanning industries from engineering and aerospace to pharmaceuticals and oil and gas) both for domestic and export markets. It has recently acquired a six-figure loan from CDFIS **Finance for Enterprise** and the **Business Enterprise Fund** (delivered through the Northern Powerhouse Investment Fund) to expand in the export market and its premises to 18,000 square feet.

Source: Responsible Finance[lxiii]

By providing finance for underserved customer groups, CDFIs increase the number of viable borrowers who access finance, facilitate enterprise creation, contribute to levelling up and remedy underrepresentation in SME finance. CDFIs also address the gap identified in evidence for this inquiry of a lack of support for small businesses, as the majority of CDFIs provide mentoring and support to improve SME outcomes and aid their growth; CDFIs provided nearly 40,000 hours of support to SMEs in 2020.[lxiv]

"CDFIs work extremely well in the start-up market" – *Patrick Magee, British Business Bank*

"It's not just about the finance – it's about the advice and guidance alongside that" – *Richard Jeffrey, The Growth Company*

Case study 2: Prima bakery

Mark and Lynne Norton sought to take over a long-established bakery business, Prima, in Cornwall after relocating there from France, with plans to raise finance to supplement their own funds. When the sale of their property in France fell through, the bank would not consider it as collateral. They were accepted for £20,000 of finance from SWIG Finance, a CDFI, to safeguard 19 jobs. The business now employs 96 people, distributing baked goods in supermarkets across the country. The business has remained resilient during the pandemic, and as well as not needing to furlough or lay off any employees, they were able to take on another seven new employees to meet demand. As well as this, they have supported struggling families through offering low-cost meals.

Source: Responsible Finance[lxv]

Mutual banks

Mutuals are financial institutions chartered by central or regional government, owned by depositors and operating without shareholders, meaning profits are redistributed to members. Their core market is typically small business (as well as households), and they deliver a customer-centric approach. Since the Co-operative and Community Benefit Societies Act 2014 opened the door for mutual banks to re-establish themselves in the UK, a number of mutuals have emerged and are currently pre-trading as they seek regulatory approval (see Box 1 for a brief summary of a number of these).

However, friendly societies and mutuals have existed since the 18th century, in the form of mutual funds to which members contributed and could in turn be used to support members in times of poor health or age.[lxvi] There were around 27,000 mutual societies registered by the late 1800s, and the UK mutuals sector was one of the largest in Europe prior to a wave of demutualisation in the UK in the 1990s.[lxvii]

Because of their regional structure, the scaling up of regional mutuals can play a role in delivering customer-centric, relationship-based banking and making use of 'soft' information to assess SME customers for credit, mitigating the issue of viable SMEs being declined for loans by larger banks as a result of not having a track record or other concretely recorded background. This could have positive knock-on impacts on regional growth and support levelling up in the UK, as mutual banks reinvest capital into their regions, bolstered by a strong understanding of their region's business landscape.

"What small scale regional banks do well is lending to small scale, regional businesses" *– Tony Greenham, Director at the Mutual Banks Association*

Mutuals face some key challenges in becoming part of the solution to SME finance. Access to capital is named the "single biggest" barrier in a Finance Innovation Lab report, which describes mutuals' predicament as a catch 22, in which they would historically have raised capital through trading with members, but under modern banking regulations need to raise sufficient capital in order to trade in the first place.[lxviii] Turning to other ways they could raise capital, these also present issues, as traditional investors tend to seek a return on capital which is higher than is expected from the purpose-driven model of mutuals, and short time frames for returns, which are also incompatible with such a model.

Though mutuals exist successfully in many other economies, the UK does not have the same purpose-driven finance network as in other countries. Evidence in our inquiry highlighted that once mutuals do begin to trade, there is also the question of competition law and how this would hamper the ways in which mutuals are able to share the administrative load (as do regional banks in other countries – examples can be found later in this chapter) and deliver the best service for SMEs and other customers. However, the mutuals movement in the UK remains optimistic that these barriers can be overcome, and our recommendations (Chapter 4) consider ways to facilitate this.

Box 1: Prospective mutuals in the UK

South West Mutual aims to be the only cooperative bank with a sole focus on the South West, and to support sustainable regional prosperity through relationship-driven banking for individuals, families, social enterprises and SMEs, acknowledging that these groups are often not the priority of larger banks. They stress the importance of a branch model with branch managers overseeing lending decisions, informed by close relationships with the local community. South West Mutual have had investment from local councils and are seeking regulatory approval to offer current and savings accounts, personal and business loans, and mortgages.

Salt Mutual Bradford aims to be the Yorkshire and Humber region's first cooperative bank, named after Sir Titus Salt, a businessman and Bradford mayor in the 19th century who set an example through putting considerable resource into the health and wellbeing of his workers.

North West Mutual is a joint endeavour from Preston City, Wirral and Liverpool Councils to set up a community bank for the North West. It gained approval under seal in 2020 from the FCA. North West Mutual aims to open main and satellite branches in the North West, to support local businesses and individuals neglected by mainstream banks and build regional economic resilience.

Banc Cambria will be a cooperative bank for Wales, developed with support from the Welsh Government, including financial assistance. Banc Cambria will seek to offer a full banking service, and hopes to acquire a license by this coming autumn (2021).

Sources: see endnote[lxix]

Ultimately, the evidence considered by the inquiry suggests that mutuals could play a strong role in improving the supply of finance to SMEs across the country. However, it needs to be recognised that these are start-up mutuals, and so do not carry the legacy benefits of similar institutions in jurisdictions such as Germany. Given the policy imperative to ensure their success, there is a role for Government in helping to capitalise these bodies initially.

Challenger Banks and Alternative Lenders

In this section we use the term 'alternative lenders' to include non-bank lenders (such as peer-to-peer platforms / marketplace lenders and specialist lenders) and 'challenger banks' (which encompass a range of banks offering an alternative way of banking for personal and business customers). These forms of alternative finance have been disrupting the traditional banking sector for a number of years, and continuing to grow in recent years alongside a boom in fintech.

Though challenger banks are also shareholder-driven, their business model differs from established high street banks (sometimes referred to as 'legacy banks'), as they are less reliant on traditional lending models.[lxx] Challengers have a smaller or no physical branch network and are not hostage to maintaining legacy systems, contributing to their ability to operate at a lower cost than traditional banks. Alternative lenders' business models allow them to be responsive and agile to customers' needs, integrate new innovations swiftly and respond to wider market trends. As well as contributing alternatives to the traditional banking sector and greater choice for SME finance, there is diversity within the alternative lenders and challenger sector. For example, in terms of challengers, some such as Metro Bank and Handelsbanken (see international examples later in this chapter for more information), branches are a fundamental part of their services and approach to customer relations, while digital-only or digital-first challenger banks (sometimes referred to as 'neo-banks') employ an app-based approach. Some banks, such as Monzo, began with a pre-paid card offering before acquiring a full banking license, while others like Starling launched as a fully licensed bank.

Two fundamental characteristics many alternative lenders share are innovation and customer experience; their ability to deliver on these may enable these providers to fill gaps left by the traditional banking sector. For example, setting up an account with a digital-first bank can take a matter of minutes, peer-to-peer platforms can make a decision on a loan application almost instantly (with customers receiving the money within days), and branches such as those of Metro Bank offer convenience through being open seven days a week.

However, despite their potentially attractive offering, alternative lenders come up against a number of challenges in increasing their market share. For example, challenger banks face a relatively greater regulatory burden (including the amount of capital it is necessary to raise) compared with legacy banks, which hampers their ability to grow, and to be more relationship driven. There are also demand-side challenges such as a relatively low awareness of Open Banking among SMEs, and SMEs' reluctance to share data with third parties (contributed to in part by a lack of SME trust in financial institutions).[lxxi] There has been some funding from the Government for challenger banks, such as the £425 million Capability and Innovation Fund, and up to £275 million for the Incentivised Switching Scheme funding to encourage RBS SME customers to switch their current accounts to an eligible challenger bank; however, the issues these models face are considerably broader, and these need to be overcome in order for challenger banks and alternative lenders to increase their position in the SME market.[lxxii]

Challenger bank Starling and alternative lender Tide were accredited to provide loans under the Bounce Back Loans scheme (see Box 2 for information on coronavirus loans programmes), both experiencing record demand as a result, and Starling and OakNorth were among FinTechs accredited for the Coronavirus Business Interruption Loan Scheme.[lxxiii] However, despite being accredited for BBLS, Tide was unable to lend to meet this demand as it could not access the Term Funding Scheme, through which the Bank of England provides funds at a cheap rate, reversing efforts to diversify the sector by essentially excluding most providers outside of the main banks. In addition, other alternative lenders were admitted to Government guarantee schemes later than many of their traditional bank peers and faced further obstacles to providing coronavirus loans, needing to negotiate new funding lines for CBILS and not meeting Government-mandated interest rates for BBLS.[lxxiv] Despite these obstacles, when alternative lenders were accredited they were a driver of lending through the scheme, outperforming the majority of their larger bank peers to deliver 27% of the number of approved CBILS loans.[lxxv]

Challengers and FinTechs are diverse in both their nature and their offering, making them a crucial element of maintaining competitive pressure on established high street banks and in reforming finance to work better for SMEs. However, Challengers and FinTechs are held back by regulatory barriers, including current MREL requirements, which inhibit their ability to fulfil their potential and address the gaps in SME finance. The inquiry has seen evidence that the current MREL thresholds place UK based challengers at a disadvantage in comparison to US and Europe.

British Business Bank

The British Business Bank (BBB), wholly owned by the Government, was established to make finance markets work better for SMEs and support their growth, through increasing the supply of finance, increasing diversity in the market, and ensure better information for SMEs. It runs a number of programmes to support these aims, some of which are outlined below.

Box 2: British Business Bank loan schemes

Start Up Loans

The Start Up Loans programme began in 2012 and has supported over 80,000 businesses through £600 million in loans. Applicants must be unable to secure finance from other sources and be starting up or have been trading for less than 24 months. The loans are Government-backed and can be up to £25,000 (the average loan being £7200) with a fixed interest rate of 6% a year over 1–5-year term. Alongside the loan, the scheme provides 12 months of free mentoring and advice for successful applicants.

Coronavirus Business Interruption Loan Scheme (CBILS)

Launched in March 2020, CBILS provided loans of up to £5 million for businesses with a turnover of less than £45 million, delivered through over 90 accredited lenders. The first 12 months of interest and lender-levied fees were covered by the scheme. Under £250,000, lenders would not take a personal guarantee, while for finance over this sum, the taking of a personal guarantee was at the discretion of the lender (but subject to a cap of 20% of outstanding CBILS facility after proceeds of business assets applied and on the condition that a principal private residence could not be taken as a security).

Bounce Back Loan Scheme (BBLS)

The Bounce Back Loan Scheme was launched in April 2020 launch and ran for a year to provide up to £50,000 of financial support through accredited lenders and partners of up for businesses negatively impacted by the pandemic (for example, through losing revenue or seeing their cashflow disrupted). Businesses could use ‘Pay As You Grow’ for these loans. The scheme also ensured a full government-backed guarantee.

Recovery Loan Scheme

The recovery loan scheme was launched in April 2021 to provide financial support from BBB-accredited lenders to businesses affected by the pandemic in order for them to recover and grow. The scheme offers up to £10 million per business, or £30 million per group, and finance can be used for “any legitimate business purpose”. Though it can be used in conjunction with other Covid-19 loan schemes, this may impact the amount a business can receive from the scheme.

Source: Adapted from the British Business Bank

The inquiry has heard a range of positive feedback about the role of the BBB, and we see that in the future it could play a bigger, but also better targeted role in supporting levelling up and the economic recovery from the pandemic.

International examples

We outline below the respective SME finance models in Germany, the US and Sweden, which are examples of how relationship-driven banking which caters for SME customers can simultaneously be profitable and ensure regional and national economic resilience.

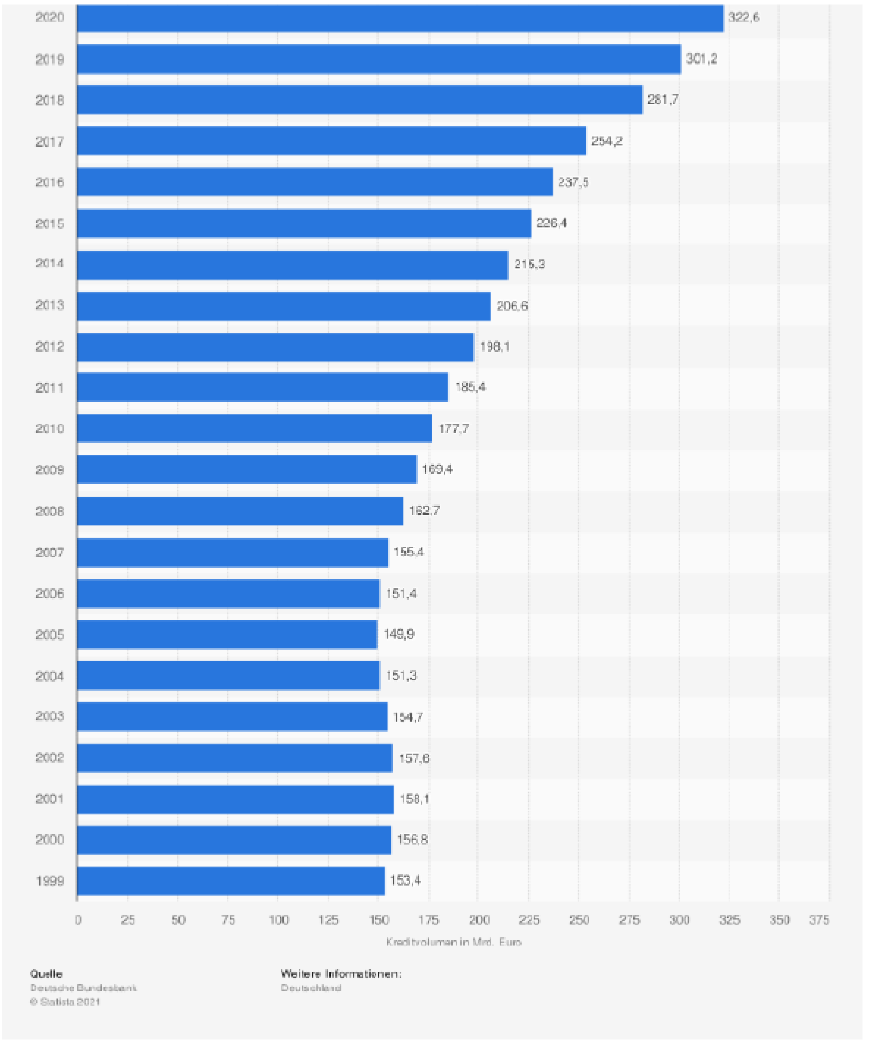
Germany

Germany's SMEs have good access to finance, bolstered by a regional banking system and strong relationships between banks and commercial customers, and supported by KfW financial instruments. Banks are organised within a 'Three Pillar System' of private banks, savings banks and cooperative banks, the latter two of which are relevant to small business finance.

Savings banks are 'quasi-public enterprises' with the goal of providing efficient and profitable banking services to their respective regions.[lxxvi] They are subdivided into over 400 'Sparkassen' and seven 'Landesbanken'.[lxxvii] By law, these banks' activities are geographically restricted and must prioritise lending to regionally-based customers.[lxxviii] Sparkassen are financially stable institutions with strong credit ratings, and have demonstrated a number of benefits both to SMEs and the wider financial system.[lxxix] They have been shown to reduce SMEs' financial constraints by 3-10%, and were swift to react to mitigate the effects of the global financial crisis.[lxxx]

Cooperative banks, of which there are 819, [lxxxi] operate under a membership system. [lxxxii] Between 1999 and 2020, cooperative banks in Germany granted around €322.6 billion in loans to domestic companies and the self-employed, a twofold increase in this period (Figure 2).

Figure 2: Volume of cooperative loans to businesses in Germany over time

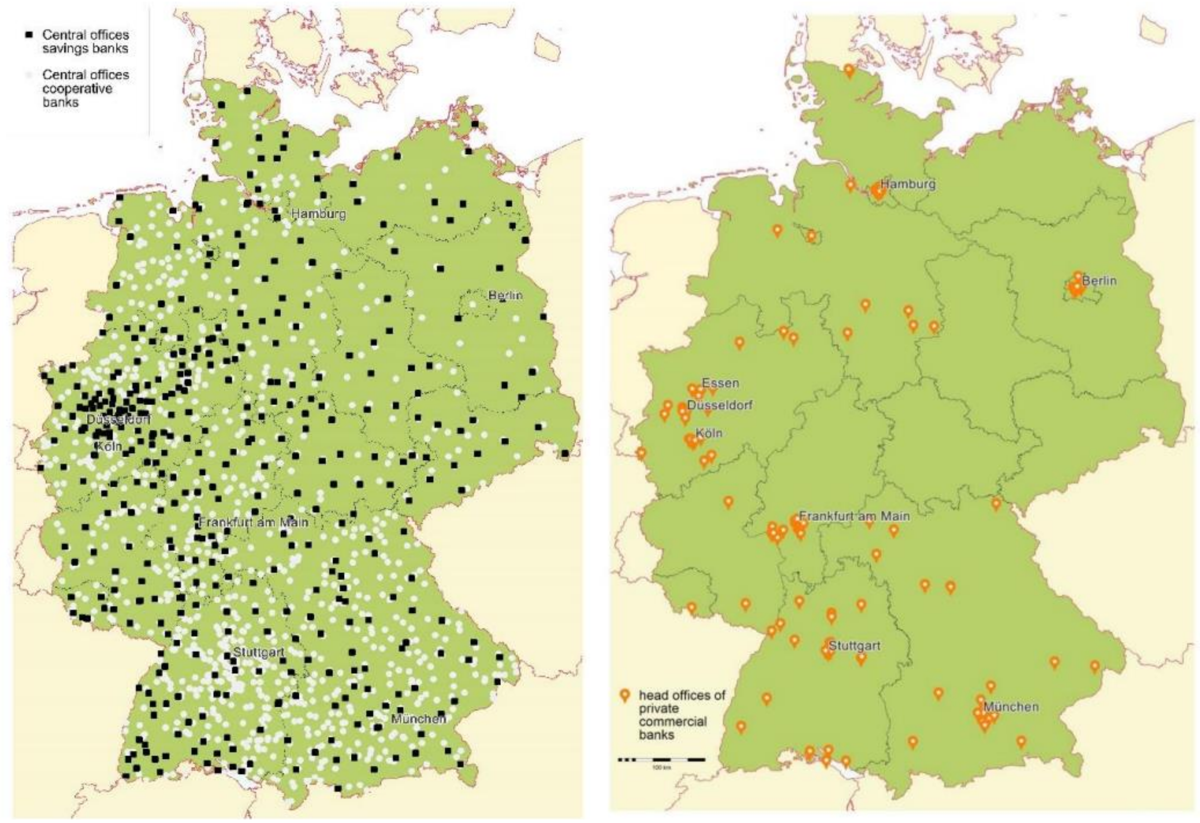


Source: Evidence from the Bundestag

A study by Flögel and Gärtner comparing different countries' banking systems concluded that Germany's system is the most decentralised, and that this system's success can be attributed to a number of characteristics and mechanisms. Savings banks' right to make loans has been long established in Germany, with an accompanying tradition of lending to small businesses.[lxxxiii] In addition, physical and operational proximity between banks and SMEs facilitates access to 'soft' information (a key gap highlighted by expert contributors to evidence for this inquiry). [lxxxiv] The embedding of regional banks into banking associations (which audit member banks, deliver a range of services for members and provide risk management tools) mitigates the effect of regional banks' distance from financial centres, meaning they can still access advanced banking knowledge and services while maintaining proximity to their customers.[lxxxv]

There is a wider impact of the decentralised system on regional growth; savings banks and cooperatives are the only banks in some regions.[lxxxvi] When examining Germany's system by county, there is a significant impact of the presence of the decentralised banks on growth and employment in less wealthy counties.[lxxxvii]

Figure 3: Map of cooperative and savings (left) and commercial (right) bank headquarters in Germany



Source: Flögel and Gärtner[lxxxviii]

Box 3: KfW in Germany

KfW is Germany's federal promotional bank, which provides loans to a range of customers, including businesses. Among the bank's other areas of focus are financing small businesses and start-ups and improving access to capital for young technology-oriented growth companies. Applications for these programmes are made through the savings banks as well as other financing partners, further strengthening their importance in the small business finance landscape.

Source: Adapted from written submission from the German Bundestag

United States

The US community banking system is another example of a decentralised banking system driven by relationship-based, locally targeted banking, and comprises nearly 5000 community banks specialising in SMEs and local family business.[lxxxix] Most community banks in the US are privately and locally owned, and therefore can prioritise the long-term needs of the local community.[xc]

These banks are profitable, with the Federal Deposit Insurance Corporation (FDIC) reporting faster growth in return on asset ratios, higher net interest margins, stronger asset quality and higher loan growth rates compared with their non-community counterparts, and a continued resilience during the Covid-19 crisis.[xci] Despite changes occurring in the US community banking sector – namely a greater focus commercial rather than local lending, mergers which have reduced their numbers by nearly 70% to 4900 in 2019, and the impact of fixed compliance costs weighing disproportionately on smaller community banks – community banks are still a key facet in SME finance and in areas which do not benefit from centralised banking, and made more than 40% of loans to small businesses. [xcii]

Another key element of the US business finance landscape is the Small Business Administration (SBA). The SBA is an autonomous government institution tasked with providing assistance to small businesses to start up and grow, with the ultimate aim of strengthening the US economy more generally.[xciii] It helps small businesses access loans through a range of partner lenders, and typically, approves between $25 billion and $30 billion of loans a year.[xciv] To mitigate impact of pandemic, $800 billion in forgivable loans to nearly 12 million businesses (the vast majority of which are small businesses) has been provided through the Paycheck Protection programme.[xcv] Alongside this, the Microloan Programme has provided another $85 million to nearly 6000 small businesses in the same period.[xcvi]

Sweden

One of Sweden's largest banks, Handelsbanken, delivers its services through a decentralised approach by giving individual branches considerable autonomy to serve the local area as they see fit, underpinned by the philosophy of "the branch is the bank" and strong relationships with customers through face-to-face interaction.[xcvii] As with the German approach, geographical restrictions are in effect to ensure a focus on local provision is strictly maintained.[xcviii] To allow branches to be flexible to local needs, under the remit of each branch are the approach to marketing products, customer segmentation policies and financial product pricing, amongst others.[xcix] As with other models discussed in this section, local, customer-centred approaches do not need to come at the expense of profitability, as demonstrated Handelsbanken's performance in the wake of the global financial crisis (above many of its peers) and in terms of its return on equity (10-15% since 2000). This strong track record is attributed by experts to its focus on and understanding of local provision.[c]

Handelsbanken has also been operating this decentralised, local relationship banking model in the UK since 1982, now numbering over 200 UK branches in addition to other markets,[ci] and growing their branch network as other banks were reducing theirs.[cii] Evidence to the inquiry heard that as was the case in Sweden, Handelsbanken remained resilient during and in the wake of the global financial crisis:

"It's one of the fastest growing banks in the UK, it needed no bailing out during the financial crisis, it's one of the best rated banks and it has been extremely successful in terms of its profitability for its shareholders." *– Professor Colin Mayer CBE FBA, Saïd Business School, Oxford University*

Chapter Four: Policy interventions

The evidence considered as part of this report has discussed:

- The problems that SMEs face in accessing finance;
- The consequences this has in terms of preventing businesses to scale, levelling up the regions of the UK, and economic and business resilience;
- A range of different alternative models to the large commercial banks, including CDFIs and Mutual Banks domestically, plus international models in Germany, the USA, and Sweden.

In order to strengthen SME access to a more diverse range of finance models and level up the UK, a coherent strategy of policies is required which need to:

1. **Deliver a strong local finance option for every business in the UK** – by providing capital to regionally based CDFIs and mutual banks which they will then multiply by lending to thousands of local businesses, and also ensuring that mutuals can share resources in order to allow them to scale, as already happens in other jurisdictions. In the longer term, a mandated portion of bank lending should come through CDFIs in order to allow them scale their offerings further.
2. **Turbocharge the challenger bank and non-bank lending sector** – these companies have provided a welcome challenge to the big four banks since the global financial crisis, however they are hamstrung by regulation which needs to be urgently addressed, including by reform to the MREL rules and access to the Term Funding Scheme for non-bank lenders.
3. **Unlock patient capital for growing companies** – the Government should build on its welcome work on unlocking patient capital from pensions funds and copy an approach in France where a social usefulness criterion is used to unlock money for investment in long term, socially important companies.
4. **Ease the finance application process to encourage borrowing for growth** – by ensuring that business support services – such as through Local Enterprise Partnerships – are properly funded and the Bank of England continues to promote the use of Legal entity Identifiers.

The full range of recommendations proposed by the inquiry are set out below.

Policy Proposal	Description	Impact	Responsibility
For immediate/near immediate implementation			
Develop proposals on access to finance in upcoming Levelling Up white paper	This would correctly place improving access to finance as central to delivering levelling up, alongside other important elements such as infrastructure delivery.	Medium	Central Government, No. 10
Extend the Term Funding Scheme to non-bank lenders	The large banks have been able to claw back market share from challenges due to access to cheaper wholesale capital through the Term Funding Scheme. It is imperative this is not repeated, and so access to Term Funding must be extended to challenger banks/non-bank lenders.	High	HM Treasury, Bank of England
Issue a Competition law exclusion order to permit the sharing of resources by different regional mutuals	This would help give legal assurances to mutuals to scale their offering to businesses through delivering operational efficiencies.	Medium	Secretary for State for BEIS
Reform the pension charge cap for Defined Contribution pension funds to facilitate more investment in patient capital	Allow for a small element (5 or 10%) of a pensions fund to be excluded from aspects of the DC charge cap to support long term illiquid investments - possibly with a social usefulness criterion as in France.	High	Department for Work and Pensions
Recapitalise the Regional Growth Fund special purpose vehicle	Detailed modelling by Responsible Finance shows a commitment by the UK Government of £50m in new first-loss capital for each year for five years could lead to adding over £1bn in new lending capacity for CDFIs.	Medium	BEIS
Secure the role of the LEP growth hubs to provide ongoing support	As part of its review of LEPs, government should ensure that funding is secured that allows them to continue to offer support and advice for businesses wishing to access finance, working with other structures such as the Chambers of Commerce.	Medium	BEIS and MHCLG
Use expanded Dormant Assets Fund to provide initial investment for regional mutuals	The expanded Dormant Assets Fund should be used to provide initial capital to the soon to be established regional mutuals.	High	DCMS

Review and improve the Bank Referral scheme	Work needs to be done to improve the effectiveness of BBB's bank referral scheme, which the BBB should look to carry out in consultation with its various stakeholders	Medium	BBB
Expand Regional Angels Programme from £100 million to £500 million	Expanding the funding available to the BBB for the Regional Angels Programme would allow them to make an even larger impact in closing the gap between London / the South East, and the rest of the UK.	High	HM Treasury and BEIS
For medium/long term implementation			
Reform to the minimum requirement for own funds and eligible liabilities (MREL) for small and medium sized banks	The Bank of England should make use of post Brexit regulatory freedoms to lower capital standards for small and medium sized banks, if they only lend to domestic firms. This would involve the disapplication of certain elements of the Basel III accords.	High	BoE
Review capital requirements against lending to SME housebuilders	The Bank of England should also review whether capital requirements against this type of lending are too high, as the inquiry has considered evidence that this acts as a barrier to development.	Medium	BoE
Long term plan to scale the resources of the BBB to ultimately a similar scale to the SBA in the US	Ultimately, the government should aim for the large-scale small business support in the US to be replicated by a system of guarantees issued with the support of the BBB in the UK. This could help to fully harness the role that finance in the UK can play in levelling up.	High	HM Treasury and BEIS
Consider re-establishment of 3i, or similar vehicle	Central Government to scope out a new Bank of England backed venture capital bank, such as 3i or its predecessor the Industrial and Commercial Finance Corporation (ICFC), to provide capital which can help scale early-stage companies.	High	HM Treasury, BEIS, Bank of England
Extend the use of legal entity identifiers	Bank of England to continue to champion Legal Entity Identifiers as an international means of business identification, in order to help ease the	Medium	Bank of England

	finance application process for businesses.		
Mandate large bank investment or lending through social lenders, such as CDFIs.	In line with similar Community Reinvestment Act obligations in the US, introduce legislation to mandate that banks over a certain size lend a certain proportion to CDFIs in order to help social lenders scale their role in the market.	High	Central Government

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