

Treasury Committee

Oral evidence: SME Finance, HC 27

Wednesday 6 December 2023

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Members present: Harriett Baldwin (Chair); Mr John Baron; Dame Angela Eagle; Drew Hendry; Danny Kruger; Keir Mather; Siobhain McDonagh; Anne Marie Morris.

Questions 77 – 149

Witnesses

[I:](#) Theodora Hadjimichael, CEO, Responsible Finance; Andrew Harrison, Managing Director, Customer Propositions and Delivery, NatWest; Lisa Jacobs, CEO, Funding Circle; Mikael Sørensen, CEO, Handelsbanken.

Examination of witnesses

Witnesses: Theodora Hadjimichael, Andrew Harrison, Lisa Jacobs and Mikael Sørensen.

Q77 **Chair:** Welcome to this afternoon's session of the Treasury Select Committee in our inquiry into access to finance for small and medium-sized enterprises. Can I start by inviting our witnesses to introduce themselves? I will start on my left with you, Andrew.

Andrew Harrison: I am Andrew Harrison. I am the head of customer propositions and delivery at NatWest.

Mikael Sørensen: I am Mikael Sørensen. I am the CEO of Handelsbanken.

Theodora Hadjimichael: I am Theodora Hadjimichael, the chief executive of Responsible Finance.

Lisa Jacobs: I am Lisa Jacobs. I am the CEO of Funding Circle.

Q78 **Chair:** Thank you for coming in this afternoon to give us evidence. I just need to explain a few logistics. I have to present a private Member's Bill during this session. You will see me ask my questions, politely duck out and then return. Someone else will sit in the chair while I do that. I apologise in advance for not being able to be here for some of your responses.



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This is a really important and timely subject. I wanted to start by asking all of you a sweeping and open-ended question. How do you see the current landscape for lending to small and medium-sized enterprises in the UK? How have things changed since the Committee last looked at this subject in 2018? Andrew, given the size of your firm, I will start with you, if I may.

Andrew Harrison: Yes, I am very happy to start. We have seen some very interesting changes. First, if you look at 2022, it was a record year in terms of the amount of lending into the SME sector. Around about £65 billion of lending went into SMEs during that year. For comparison, in 2016 it was around about £59 billion. You can see that the level of lending going into the sector has been rising. Clearly, Covid caused a blip in that chart because of the amount of Covid lending that happened. On a normalised basis, the market is very active.

Secondly, there is probably now a greater breadth of choice for SMEs than there was previously. Out of that £65 billion, 55% is coming from alternative lenders such as challenger banks, etc. The share of the high street banks in that overall pot has dropped, but the pot has got bigger. That is a good thing because it shows there is more choice and selection for customers.

Another trend that we have seen is a growth in brokers. Businesses are looking for more help and support around what options are available to them. The broker market has become increasingly important to small businesses.

Those are some of the key trends. The core underlying behaviour—about 50% of small businesses and SMEs are long-term non-borrowers—has not really changed. We did see more businesses borrow through the Covid schemes, particularly with bounce-back loans. Again, we have seen that those businesses that borrowed for the first time are tending to repay and not coming in for further follow-on finance. A business that had more conventional or traditional debt is four times more likely to come back for more finance than a business that only had a Covid bounce-back loan.

Q79 Chair: Yes, that was quite a distortion in the market. I wonder whether I might turn to you, Lisa. How would you compare this period to 2018? What was the impact of the bounce-back loans that were available in this sector? How did that affect your perceptions of this sector of businesses?

Lisa Jacobs: I would agree with a lot of what Andrew has said. Over the last decade, while I have been involved in SME lending, it has been really great to see that increase in choice and competition. The work of the British Business Bank in supporting that by bringing other options for small businesses to access finance has been really good.

As you and Andrew have said, throughout the Covid period we saw a huge increase in lending to support a number of small businesses through



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the various loan schemes that were in place, whether that be the bounce-back loans or the coronavirus business interruption loans. What was great about that was the opportunity we saw for a number of alternative lenders to be part of the group that could rise. We were very proud of the fact that we could support small businesses in that way.

Since Covid, we have all been hoping to be on an upward trend, but it has been challenging for small businesses. We have seen that coming through in demand for lending. We did a survey of a number of our small businesses at the start of this year. About half of them said that they had postponed investment decisions due to the current climate.

Q80 Chair: You are saying that demand has dropped.

Lisa Jacobs: Yes. Demand from a certain group of businesses has definitely dropped. They are hunkering down. They are focused on how they can see out this period.

We have seen demand for working capital. Over the same period, you have a decrease in demand on the investment side and more of an increase on working capital, as small businesses are having long payment terms. We have seen a change in the reason that small businesses are coming to us to ask for finance.

Q81 Chair: Mikael, I want to ask you the same sort of open-ended question. As I understand it, your business really focuses on this sector.

Mikael Sørensen: Yes, we are one of the challengers, as you might call us. SME lending is one of the foundations on which we have built the bank. We did see rapid growth in our lending volumes up until the outbreak of coronavirus. We decided to participate only in CBILS and not the bounce-back loan scheme.

We then saw a plateau in the demand for lending. Over the last year, we have seen a slight decline in the net figure on our lending book. That is not so much because we do not lend out to new customers—we are doing that—but because many of our cash-rich customers have decided to use their cash balances to pay their increasingly expensive loans due to the level of interest rates.

This year we have seen new lending to SMEs that is more or less in line with what it was before the outbreak of coronavirus, but the net figure is down because of the repayments.

Q82 Chair: Are you able to distinguish what is due to the higher interest rates that everyone is having to pay now compared to the impact from the drawdown of these loans?

Mikael Sørensen: It is a combination. It is partly to do with the high interest on the lending book, but it is also because they are lying low with new investments. We have a lot of property investors in our customer portfolio. They have decided to take a step back for as long as there is



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still uncertainty on property prices in the UK. It is a combination of lower investment from our customers and increased interest rates.

Q83 **Chair:** Theodora, did you want to add any other angles to this from the community sector?

Theodora Hadjimichael: Yes, definitely. I come at it from a different angle; we have a different perspective. We have seen that access to finance for small businesses is still a really big problem. For some cohorts of businesses, it has been getting worse.

Responsible Finance is a trade body for community development finance institutions or CDFIs. They lend to businesses and social enterprises that cannot get finance elsewhere. They have observed that it has been getting harder for a lot of businesses to access finance from banks and other sources.

In particular, we have observed three trends over the past few months. First, as Lisa said, the demand is there and is high, but the quality is getting more variable. That is because of increased prices due to inflation. It is taking longer to work with these businesses. We are still getting to yesses, but it is taking longer to get there.

Q84 **Chair:** With higher interest rates being the transmission mechanism for the Bank of England's efforts to bring inflation down, are you seeing that with your lens on the small and medium-sized sector? Is this having a significant impact or are businesses still cushioned by things like the Covid bounce-back loans?

Andrew Harrison: Higher interest rates are driving customer behaviour. A lot of liquidity went into the sector through Covid, whether that was through lending or the furlough scheme. Lots of businesses exited Covid with a lot of cash on balance sheet. If you are facing into higher interest rates, the logical thing to do is to use the surplus cash to repay borrowing that is at a higher rate.

It has probably encouraged businesses to do the logical thing, if they do not have a way to invest that additional cash today, which is to de-lever. That has happened. It is not all about the interest rate. It is also about access to labour, the cost of labour and access to new markets.

There are still the broader challenges that business has faced for some time in terms of the skills and capabilities to be able to grow and scale. Those fundamental and core foundations have not gone away. They still exist.

Q85 **Chair:** Overall, everyone is seeing a reduced demand for borrowing in this sector. You would all agree with that statement.

Lisa Jacobs: Let me just qualify that. We are seeing a reduced amount of investment. Overall demand has been relatively stable, but there has been a shift away from investment into much more working capital. The



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biggest challenge facing small businesses, outside of interest rates, is stability: economic, political and policy stability.

When I speak to some of our customers, they say, "Over the last 10 years, the environment has been really challenging to operate in." We have had Brexit, which caused a huge number of challenges. We had Covid, which was very difficult. We are now in this cost of living crisis. Through that period, they have been asking for some certainty and stability, which will give them the confidence to invest.

I was with a restaurant here in London a few months ago. The restaurateur's view was, "Even at these rates, I can increase my pricing and have reasonable investment off the back of this. It still makes sense to borrow." You do see those businesses where they look at it from an investment case perspective and say, "Can I pay back this loan?" If they have been able, as he was, to push through the price increases that they have seen, it has inflated everything as it has gone on.

Theodora Hadjimichael: We have seen increased demand, particularly from some specific groups. In addition to the core customers that find it difficult to access finance elsewhere, we are seeing a slide down. What were previously bankable businesses seeking larger loan sizes are now unable to get finance from their bank, so they are going to alternative lenders like CDFIs.

The last thing we are seeing a lot of, which is a huge difference from a few years ago, is the increased use of high-cost short-term loans by small businesses to finance growth. Because these businesses are very small, a lot of their working capital often gets eaten up by the high interest rates. They are not able to invest in their business and they are being really squeezed.

One of our members said that almost one in five of the applications they see are to refinance high-cost debt. We are really worried about that trend. It is one other challenge that small businesses are facing.

Q86 **Chair:** Overall, has the Bank of England gone far enough in terms of raising rates, as far as your small and medium-sized businesses are experiencing things?

Mikael Sørensen: That is a good question, which I am not able to answer. It has definitely had the desired effect so far. It has really lowered investment in the corporate world. Whether or not it is enough is not for me to say.

Q87 **Chair:** Does anyone else have a different view on that? Does anyone else want to express an opinion on the level of interest rates small and medium-sized businesses are having to pay now?

Mikael Sørensen: One thing we can say is that we have not seen the full effect of the increased level of interest yet. There are a number of businesses, especially within the property industry, that have had fixed



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loans for a number of years. It is only when those terms expire and they need to fix for a new period that they will experience those increased interest rates.

Chair: Some of it is still to feed through.

Mikael Sørensen: Yes, absolutely. That goes for corporates, SMEs and private individuals.

Chair: That is all very interesting. I am now going to bring in my colleague Anne Marie Morris on the interesting subject of account closures and debanking.

Q88 **Anne Marie Morris:** It is very topical. Mr Harrison and Mr Sørensen, how common is it in this sector for accounts to be frozen or closed, both absolutely and relatively compared to other sectors and larger businesses? Mr Harrison, do you have any preliminary comments to get us going?

Andrew Harrison: If you look at our overall customer base, the level of account closures or exits is something like 0.03%. The vast majority of our customer base are small businesses. Of around 1 million customers, about 900,000 of them are small businesses. There is no particular trend there other than the fact that there are more small businesses. In absolute terms, that is probably where you would see the volume.

The important thing to bring out is that 99% of any exit we make as an institution is for fraud and financial crime reasons. This is a really important issue for the UK economy. We work very closely with the regulators on this. We are quite restricted in what we can say to businesses at an exit because of some of the regulation around tipping off and things like that. We work very closely with the regulator to help us be able to provide a more detailed explanation to businesses of why they might be impacted by this.

Q89 **Anne Marie Morris:** That makes it quite difficult for small businesses. You are telling me that you cannot talk to them, so they suddenly find themselves debanked. Is that effectively what you are saying?

Andrew Harrison: We are very restricted. The vast majority of exits are due to fraud and financial crime concerns. In those situations, because of law and regulation, we are very limited in what we can say to those businesses without tripping over some of the legal aspects around tipping off. That is the difficulty we have in terms of being able to fully describe to businesses what might be happening.

Q90 **Anne Marie Morris:** Do they have a right of reply? Do they have any opportunity? It sounds rather as if they are condemned before there is a full investigation. A full investigation ought to give them, you would think, the opportunity to make their case and say, "You have got it wrong. You have been misinformed." What is the solution? What is the redress? What is the fair outcome for an SME?



Andrew Harrison: First, this is an important issue, but it impacts a small number of our overall customers. We also have to look at this in context. The fraud and financial crime environment we are in is escalating. There is about 300% more fraud going on across the UK economy than there was previously. It is important that we do have the appropriate protections in place to process the wider system.

If a business is impacted and is not happy with that position, there is the ability to complain to the bank. We have a full process around that. We would investigate and make sure the decision we are making is the proper one. If they are still not happy, there is the ability to go to the Financial Ombudsman Service to seek an independent review. There are definitely ways that businesses can raise this.

Q91 **Anne Marie Morris:** My concern is that for some of these businesses time is quite literally money. All the processes you have described take time. How fast is your process? If I am an SME whose account is closed and I file a complaint today, how soon are you going to come back to me? How soon will it be resolved?

Andrew Harrison: When we get in a complaint, we will turn it around quickly, in a matter of days. We are not talking about weeks and months. Again, in these situations, there can be legal issues behind the scenes that make it difficult for us to respond quickly and fully to businesses.

We respond as quickly as we can. We treat this very seriously, but we have to operate within the legal and regulatory environment in which we are required to operate.

Q92 **Anne Marie Morris:** It sounds like the regulatory requirement effectively says that you are assumed to be guilty and you have to wait to be proved innocent.

Andrew Harrison: To exit a business is a very impactful thing to do to that business. It is not something we would do without any thought. We would do it if we had good and significant concerns that there is a real reason to be concerned there. We do not do it lightly. We do the research. We might be engaged with law enforcement agencies around it. Only when we have that body of evidence would we move to an exit.

Q93 **Anne Marie Morris:** Mr Sørensen, when you are looking at lending to or opening an account for an SME, a small business, of what relevance is the nature of the industry or sector it is in? It might be a pawnbroker, in gambling or in amusement arcades. We have received some evidence that these types of sectors are less favourably perceived and find it much harder to have a bank account.

Mikael Sørensen: Let me first start by explaining what kind of bank we are and then I will come to that question. We are a relationship bank built on locally empowered branches. All customers in the bank, regardless of sector, size or complexity, are customers in a local branch. It is the local



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branch that decides the type of customers it would like to co-operate with in its local market area.

All our customers have a personal account manager in our branches, also regardless of the size and complexity of the customer relationship. We find that that way of banking fits very well to typical owner-managed SMEs. That is why they are core customers of ours.

The examples you gave there are not typically the types of customers who would appreciate the added value that our branches give. Very often it is owner-managed businesses, which is a slightly higher level within the SME segment.

Q94 Anne Marie Morris: Given that these decisions are made locally across the sectors—I do not mean the SME sector versus the next size up; I am talking about the different industry sectors—have you ever done any research to look at from which sectors applications are made and what your turndown or rejection rate is for particular industry sectors? That might give you a sense of whether there are particular sectors that do not seem to be getting the support that they might.

Mikael Sørensen: We have very few particular sectors we do not want to do business in. Again, it is up to the local branch to take that decision. There are a few sectors, which are related to our ESG and net zero commitments, that we find it more difficult to work with, but otherwise there are very few sectors that we decide not to work with. We do not set that threshold from the centre.

Can I just come back to the debanking question? We want to build long-term relationships with our customers. We are a long-term bank. We are a bank with a long-term view. We appreciate building long-term relationships with our customers as well. We do not see a lot of customers that we exit or debank.

The ones that we have said goodbye to are typically customers where we were not able to get the documentation that is required for various reasons when you have a customer. We give them sufficient time to provide us with those requirements. If they are not able to do that, we part ways. That is the typical way. It is not often; it is very rare that that happens.

Q95 Anne Marie Morris: Some of the sectors I am referring to are often cash-based. Is that something that would be held against them?

Mikael Sørensen: We do not have cash or counter service in any of our branches.

Anne Marie Morris: They are automatically excluded.

Mikael Sørensen: We have a co-operation with the Post Office to service our customers as far as cash and cheques are concerned.



Q96 **Anne Marie Morris:** Theodora Hadjimichael—forgive me if I have pronounced that incorrectly—what is your take on this? Are people coming to you for help with finance because they have been debanked by more traditional high street banks or some of the new online banking organisations? Are you finding that any of them are saying, “We have been debanked”? If so, have they given you any reason?

Theodora Hadjimichael: We asked about this. Across our members, we have not observed that many instances of actual debanking of businesses or social enterprises. We did hear observations about a couple of other trends. The first is one you touched on earlier about how hard it is to open a new bank account. It seems like that is particularly acute for new starts, which do not have a track record, or sole traders, who really struggle. The impact of that, as you can imagine, is that it takes longer to get the funding because you do not have a bank account to put it in. It creates more uncertainty for the business, which is already dealing with a lot.

The second thing, which you also touched on, is the loss of traditional banking services. That is something that our customer base really misses. They get it from the CDFI sector. The quality of support and service in the CDFI sector is really good, but right now it is at a small scale. We would like to scale that up, but our customer base, which is very small businesses, businesses in deprived areas and businesses led by women or ethnic minorities, really likes the option of being able to pick up the phone and talk about their application or, if they are in financial difficulty, a new repayment plan. They really benefit from that personalised service. That is something they miss a lot.

This has something to do with demand. In the past, businesses would have had a close relationship on the ground with a bank branch or a bank manager. You might see this, Mikael. Having that relationship with a business builds a pipeline of applications for finance. They talk about what their plans are; they get some support; they put in place plans to invest. When they do not have that journey, it is much harder to get started. They do not know where to go. Business support on the ground, across the country, is really fragmented right now. That is a huge gap that we are seeing.

Anne Marie Morris: That is helpful. My colleague Siobhain McDonagh will take you further on the cash issue.

Q97 **Chair:** On this debanking question, I was not sure whether I got a straight answer from you there, Mikael, on the question of particular industries. You did refer to ESG or environmental, social and governance. Would that exclude you giving a bank account to a gambling firm? Would that exclude you giving a bank account to a firm that is involved in the defence sector? Would that exclude you giving a bank account to a pawnbroker? What are your views on that?



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Mikael Sørensen: It could prevent us from giving a bank account to a fossil fuel company.

Q98 **Chair:** Would you give a bank account to BAE Systems, for example?

Mikael Sørensen: I cannot give you that answer here. There are restrictions on financing the defence sector, but that depends—

Q99 **Chair:** You would not give a bank account to the people who keep us safe.

Mikael Sørensen: No, I can say that our bank has financed the defence industry, but there are certain parts of the defence industry that we want to stand outside of.

Chair: Really?

Mikael Sørensen: Yes.

Q100 **Chair:** Does NatWest also feel that way?

Andrew Harrison: No. We are very proud of our support of the defence industry. We are active from larger businesses through to small businesses in the supply chain. As long as the activity is legal and within the UK Government's directions, we are very proud of our support there.

Q101 **Chair:** We are in a situation where, if a firm is doing legal business in the United Kingdom, something that is not illegal, it may still be screened out of having a bank account because it fails to meet the environmental, social and governance criteria of particular firms.

Mikael Sørensen: It could be, yes. Let me just repeat that our bank does finance the defence industry, but there are certain parts of the defence industry that we feel we cannot finance.

Chair: I am going to bring in Keir, and then I am going to excuse myself while I present my private Member's Bill. Siobhain is going to take the Chair. Please forgive me.

[Siobhain McDonagh took the Chair]

Q102 **Keir Mather:** Thank you all very much for coming. I would just like to ask some questions about social enterprises and community financing, if possible. The Impact Investing Institute stated in its evidence that 99% of businesses lent to by community financing have been turned down by another lender, and yet over 90% of these borrowers successfully repay their loans and grow their businesses. I was wondering whether you think this is a clear instance of market failure in relation to these enterprises.

Theodora Hadjimichael: That is one of the statistics we are really proud of because it shows that the CDFI model works really well. We are reaching small businesses that cannot be served elsewhere. It is absolutely an instance of market failure. It shows the impact that having



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that distance from a business has on not being able to get the information needed to make a loan decision.

I will give you an example of a NatWest business. Miss Macaroon, which a lot of people might have heard of because it is in a lot of NatWest TV and streaming ads, started off as a CDFI customer. Six or seven years ago, this business tried to get a loan from a bank and could not because it did not have a track record in retail when it was trying to open a shop.

It went to a CDFI. CDFIs are much more relationship-based. They look at all of the hard data that online lenders and algorithm-based lenders look at, like credit score and so on, but they also look at the soft information like the management team, the forward viability and the local market conditions. In that case, the CDFI was able to make the loan. Needless to say, that business has gone from strength to strength. It has grown, increased in confidence and is now a mainstream banking customer because of the CDFI loan.

This is a significant service that is being provided by CDFIs. They are filling a gap in the context of the cohorts of businesses that we are talking about today, which are seeking smaller loans. They do not have perfect information because of the extremely bumpy track record that so many businesses will have had over the past few years and there is a lack of security to offer a loan.

CDFIs do a brilliant job at reaching these businesses, serving them and reaching areas of market failure. However, the sector does need to grow. We need the support of the wider industry to grow.

Lisa Jacobs: If you look across the industry, it has been well documented for years that there is a gap in small business lending. The gap is estimated to be around 7% to 15% of annual lending.

It is challenging. Small business lending is challenging. The data is much scarcer. There are a lot of differences between some of our businesses. If you think about a florist versus a manufacturer versus a landscape gardener, they are all very different. It is quite challenging to do that risk assessment.

That is why choice and competition across the market is really important. Somebody who gets rejected from one bank might get accepted by another because they have different ways of looking at the risk in that business.

In Funding Circle's case, we have done about £16 billion of origination to 140,000 businesses since we started. One of the things we have found is that we overindex in areas of higher social deprivation. About 12% of our lending goes to the 10% of local authorities with the highest levels of social deprivation.



That is because it is very accessible. It is a very quick process. We talk a lot about access, but we talk less about the importance of speed and ease. In our surveys of businesses, a third say that speed is the most important and a third say ease is the most important. They are busy people. Making that process very quick is almost as important as that overall access piece.

Q103 Keir Mather: Can I ask you a question in relation to that? Around 50% of community financing lending goes to the 35% most deprived areas in the UK. I was just wondering how you think community financing might be used as a lever to address some of those regional inequalities among the SME population as a whole.

Lisa Jacobs: I will ask Theodora to jump in as well because she probably has a clearer view on the community finance aspect. We make the process very open and accessible, and we work with market participants using referrals. Where we cannot support businesses, we refer them to other lenders. About 13% of our originations are done through that way. We call it “get to yes” for small businesses because that is what they want to do. We have found that very successful because there are businesses that sit outside our credit box but might sit within another’s. I will let Theodora talk about community financing in particular.

Theodora Hadjimichael: It is a really good point. Yes, you are right that over 50% of our lending goes into the most deprived communities—90% of our lending is to businesses outside London. Like I said before, we know the demand is really strong. From research by commercial finance brokers, the NACFB, we know there are not a lot of lenders in the sub-£100,000 space, which is where a lot of small businesses need finance to start up and grow.

There are three key things that will really drive growth in the CDFI sector so that it can play a bigger role in reducing regional disparities and disparities between demographic groups. The first is capital. CDFIs are constrained by their capital to lend. We would love to see the banks partner and invest in CDFIs more. It happens at a small scale. We would like to see it happen at a much larger scale, like it does in the US.

The second thing that could really drive that is the role of Government. There are some key things Government could do to derisk that investment for the banks. Crucially, something that is really urgent is the extension of the recovery loan scheme, the Government guarantee scheme. That plays a huge role in extending finance to unsecured businesses that do not have adequate security but have a lot of potential to grow.

The last thing that would make a really big difference is an effective referral system. That is probably something we are all very aligned on. It is so difficult for small businesses to navigate the finance space, especially if they have been declined already or they feel not so confident or are discouraged. It is really difficult to find the right type of product. A



more functional referral system would go a long way in helping businesses in deprived communities in the regions across the country get to the right type of finance.

Q104 Keir Mather: Turning to the impact of SME scale on lending, I was wondering whether each of you could outline what your ideal type of SME customer is. For example, are they capital intensive? Do they have smaller capital needs? What does that Goldilocks SME look like for you?

Andrew Harrison: From a NatWest perspective, there is not a real answer to that. We serve everything from charities and social enterprises right through to larger family-owned manufacturing businesses and everything in between.

Every year, in terms of start-ups, we open accounts for about 120,000 new businesses. They will be everything from florists to more heavy industry-focused businesses. There is not really a clear answer to that. We support all business sizes through all sectors. We are also very much a regional business. We support all parts of the UK.

Q105 Keir Mather: Perhaps to tip that on its head, is there a type of firm that is riskiest to lend to, in your view, at the present moment?

Andrew Harrison: Not so much, no, but, when we look at any lending, one of the most important things is whether that business is able to repay the borrowing it is taking on. It would not be right for the bank to provide funding to a business that does not have the ability to demonstrate it can repay those loans over a period of time. Affordability and the business's ability to demonstrate it can generate the cash flow to repay the debt is our core focus. That is what our predominant interest will be.

Q106 Keir Mather: How important is scalability in your considerations as to whether or not to lend to an SME business? Is it crucial? Is it a contributory factor but not something that is essential?

Andrew Harrison: It is not crucial, no. We are also very active in high-growth scale-up business. You tend to see different requirements. If you have a high-growth scale-up business that wants to increase in size materially over a short period of time, for that type of business, we would be working with it through our relationship manager portfolio. We have the largest network of relationship managers across the UK, about 1,100 of them. In those types of businesses, you would be looking at the future forecasts and cash flows because you are buying into that growth.

If it is a more steady-state business that is not trying to scale up, you would be looking at the cash flow and trading performance of that business over the last period of time. Does that give us confidence that it can repay the borrowing that it takes on? It depends on the nature of the request.

Q107 Keir Mather: Do lenders have a tendency to overestimate the growth of



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SME firms in some instances?

Andrew Harrison: The argument would probably be that it is the other way around. The nature of providing debt finance is that you want to be certain that you will get repaid over a period of time. We would look at forecasts and we would work with the business to understand what it is trying to achieve. We would therefore assess what we think the cash flow is over the next period of time that could underpin the debt. I do not think we overestimate.

Q108 **Keir Mather:** Finally, are sole traders and microenterprises—those non-traditional forms of SME business—subject to onerous or overly extensive levels of scrutiny when it comes to analysing their growth potential in comparison to more traditional SME businesses?

Andrew Harrison: If you take the example of a small business coming into NatWest, the majority of our lending is done through our digital platform. A customer can go through application to approval within about 10 minutes. The amount of information that we would need from that business is relatively small. That is a very fast and smooth process for the businesses that are coming through.

The higher-growth and more complex businesses tend to want to borrow more. They want us to buy into a future plan. That is where our relationship managers would be spending time understanding what they are trying to do and getting closer to that business.

Keir Mather: I was wondering whether, in a sense, the bar for lending was higher for those smaller firms. That is not your assessment. Thank you very much.

Q109 **Chair:** I am not seeking to use the Chair's privilege; my spot is next. The power is not going to my head just yet. I would like to address my questions to the area of access to cash and local branches.

First, Andrew, since the start of 2015, NatWest has closed more bank branches than any other banking group: 1,330 branches have been closed in eight years; 138 branches have closed so far in 2023; and 47 more branches will close in 2024. Is that serving the community well?

Andrew Harrison: It is a really important topic, and it is one where, rightly, there are very strong feelings. Over the last period of time, there has been a big shift in terms of customer behaviour. There are customers who really do want to use branches and continue to use branches. It is important that they can continue to access cash. However, we have seen a big shift towards customers not using branches or cash and using digital payment systems like Apple Pay and suchlike.

There has been this really big shift in the market. From our perspective, we still have 547 branches across the UK. We have a very strong branch network. Our mobile banking serves 600 communities across the UK. In rural areas, mobile banking goes into those communities.



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The final important point is that, through our relationship with the Post Office, small businesses can access 11,000 post office counters across the UK as well. From a points of presence perspective, we have about 16,000 points of presence, which businesses can use to access cash and use cash services. That is an important part of our overall proposition.

On top of that, we are very much working with the Access to Cash Action Group around branch hubs. There are 24 hubs in place. There are another 75 hubs where the industry is coming together to provide cash services to communities. That is growing, and we are very supportive of that.

We are also investing heavily in the other channels that more customers are wanting to use, so digital and mobile banking, etc. There has been a huge growth in demand in those areas. We have to fund and invest in supporting the customers who want to use branches—they are really important—and we have to make sure that we have the capacity to invest in new digital platforms, which is where we see the growing demand.

Q110 Chair: When you close a branch, you also lose the free cash machine outside your store. That is a real problem for both individual customers and the businesses in town centres. On a wider level, your bank branch closures are—I do not think it is too extreme to say—destroying town centres.

Andrew Harrison: We are very aware of our responsibilities when we are making these decisions. We do not make them lightly at all. It is really an assessment of a number of things. First, how often is that branch being used? What is the footfall? What is the trend? We also very much look at our wider presence. Do we have other branches? Is it a reasonable travelling distance? I know that can be an issue of debate, but we will look at that.

We also look at how close the post office is. Our customers can use the post office to deposit and take out cash. There is a full service through the post office. There are many more post office counters around the UK than we have branches. They have access to 11,000.

It is a really important debate, and it is something we do not do lightly, but, when we do it, we really work hard to make sure there is a strong leave-behind.

Q111 Chair: I suppose I should declare an interest. You do not have a branch in my constituency. They are all closed. You just made a reference to banking hubs. As the panel will know, when the last bank leaves town, an organisation called LINK steps in to provide a shared banking hub. The last bank is defined in the guidance as a branch that provides cash to personal customers rather than to small businesses as well.

That means there are lots of places where small businesses do not have access to cash, but there is no requirement for a shared banking hub to be created. Does that need to change? Should the criteria for “last bank”



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include business banking?

Andrew Harrison: We have the criteria. We are very much supportive of the work LINK is doing to make sure that there is a fuller assessment of the cash needs of communities. LINK is increasing its intervention in this area. It is doing more thorough analysis around what the cash needs are and how to serve them into the future.

When we look at this, we look at it very much through the lens of our customer base and our network. We look at both personal customers and business customers. We look at the distance between our branches; we look at the provision of post office services close by and whether they are at a reasonable distance. We also look at things like vulnerable customers and making sure that there is support in place for vulnerable customers before we do it.

Being the last bank in town is a factor in our decisions, but we look at a broader range of determinants before we make that decision.

Q112 **Chair:** Do the other members of the panel think that banking hubs should include business customers?

Mikael Sørensen: We have 158 branches throughout the country. If you look at the number of customers per branch, we are, per definition, the bank that covers best the UK. Our whole business model is built on the local branches. We will always have branches and we will always have that personal face-to-face interaction with our customers. That is our whole model.

For us there is no doubt that branches in the local community are really important, but, as I said earlier on, we do not have counter service in our branches. The reason why we do not have that is that we would never be able to provide the coverage that would be needed throughout the country. That is why we have teamed up with the Post Office for those services. Our customers are really happy with that.

Q113 **Chair:** There are some small businesses that still do a lot of their work in cash. From my own constituency, I could think about the local locksmith and the burger van. All these companies still do a lot of their work in cash. Should the banking hubs, which are trying to take the place of banks when all the branches close in a town centre, consider small business customers as well? Is that something that is necessary or not?

Andrew Harrison: I would say yes. That is part of the plan. Again, the banking hubs are a growing part of that ecosystem. Another 75 are coming, which is good news.

Again, I would not move away from the point that Mikael just made. The Post Office offers 11,000 counters across the UK. For a NatWest customer who is a locksmith in a town, there is very likely to be a post office in that town that can take cash and give them cash withdrawals. It can give them the same service that they would have got through the bank



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branch. We are very conscious of making sure that we do support those small businesses.

Theodora Hadjimichael: Like I mentioned before, access to banking services is something that a lot of small businesses are missing a lot and unable to benefit from anymore. Those who are disproportionately affected by bank branch closures and the loss of those services tend to be those who are lower income, are more vulnerable and have the most to gain.

Q114 **Chair:** Yes, always. Across the range, in every service, it is always those people.

Theodora Hadjimichael: I agree. If there are ways to extend service to them, that is absolutely the right thing to do. We hear from our members that the post office is not a perfect solution. The hours are limited in some places. Some close at 2 pm. It is a limited solution.

One further step that the banking hubs could be taking would be to include community finance because then you would get a link between community finance and banks. That is the pipeline that we want to build. We want to be able to send our customers back to banks so they can go on to get larger amounts of finance, and we want to be able to get from the banks referrals of customers who need finance but cannot access it.

Q115 **Chair:** There are real consequences. Certainly in my constituency, the proprietor of a mobile burger van found it harder and harder to deposit his cash at night. Unbeknownst to him, he was being followed every night. They became aware that he was leaving money in his house, and he had a very ugly violent burglary that you would not wish on anybody. There is a real human consequence to this as well as a financial transaction concern.

We have identified 27 communities where Nationwide—sorry, Andrew, I am not trying to have a go at you—which is part of the NatWest Group, is the last bank in town. We know that, as a policy, Nationwide does not serve small businesses, clubs or charities. Should there be shared banking hubs in those communities? Currently, small businesses do not have anywhere to go.

Andrew Harrison: Nationwide is not part of the NatWest Group. I do not know whether that is a misunderstanding. Nationwide is a separate building society. I can only speak from a NatWest perspective. It is not right for me to try to speak for the whole industry.

When we look at our customer base, we are very focused on making sure that there is cash provision for customers through our branches, through access to the post office if we do not have a branch, or through very close working with the Access to Cash Action Group on hubs. That is how we focus on it from a NatWest perspective.

Q116 **Chair:** I apologise for dragging you into the world of politics. I am not



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sure whether you feel able to answer this question. On Friday, our brilliant shadow Chancellor Rachel Reeves announced that a Labour Government would guarantee 350 banking hubs across the country and ensure that small businesses have access to their own cash. Is that a good policy?

Danny Kruger: Imagine that we wanted it too. Seriously, from a neutral perspective, what do you think?

Andrew Harrison: From my perspective, this is an important issue. Constructive and collaborative debate between banks, organisations such as LINK and local MPs is really important. We need to have a constructive debate about these issues. Whether that is the right number or not I could not say, but this is a good debate to have. We all need to lean into it because it is important for businesses across the UK.

Chair: We would call that a politician's answer.

[Harriett Baldwin resumed the Chair]

Q117 **Danny Kruger:** I am so sorry that I stepped out and missed a large part of the session. I really apologise. I look forward to reviewing the transcript. This is a hugely important topic. Despite the politics you have just heard, it does cross parties. We are all on the same page in terms of what we want.

Theodora, many apologies if you are giving an answer to a question you have already dealt with, but just talk me through CDFIs. How is the finance offered through a CDFI different or, indeed, better than that which is offered by the commercial banks? Can you just help us understand why in this country we seem to be lagging behind, particularly with respect to the US where they have a much stronger tradition of CDFI finance?

Theodora Hadjimichael: The key difference between CDFIs and traditional lenders is that CDFIs do not take a fully automated approach. They are relationship-based lenders. They look at the data, but they also look at the soft information like management quality. They visit the business and kick the tyres. That lets them look at some of the harder cases where there has been a no and enables them to get the information to turn that no into a yes.

I can give you a really quick example of this. A couple of years ago, there was a roofing company in Cambridgeshire that wanted to pivot into solar panels. It went to a bank and was declined because it had a really bumpy track record. It went to a CDFI. The CDFI also saw that not everything was perfect in its financials. It took the business to an accountant. Together with the business, it worked through to a realistic financial plan. Ultimately, the business got the loan and has since gone from strength to strength and added a couple of employees.



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That is a brilliant example of how it works. That is a business that would have been very easy to say no to, but the CDFI went the extra mile. It saw something. It gave the business advice, support, and hand holding to make sure that it got across the line and got to a yes. The business benefited from that as well.

You are absolutely right. The CDFI sector has not reached its full potential here, like it has in the US. In the UK, we have about 35 CDFIs in total that lend to small businesses and social enterprises. In the US, there are 1,400 CDFIs lending about \$40 billion annually.

There are a couple of key differences in the US. It is totally within our gift to make these changes here. The first difference is that there is legislation in the US that requires banks to invest into CDFIs, recognising that banks cannot serve every single customer in every single community; therefore, they have to support intermediaries that do. That generates hundreds of millions or billions in investment from banks into CDFIs every year.

The other key difference is that there is a lot of support from both the national Government and local government in the US for capacity-building and technical assistance. That means CDFIs, which are trying to keep their interest rates really low and affordable for customers, can get the support and funding they need to reinvest and provide the best services they can. Those are both things that are within our gift here.

Q118 Danny Kruger: Those would be very powerful. Lisa, turning to you on the same topic, in your written evidence you talk about the more accurate risk modelling that Funding Circle achieves. What is that? How do you achieve more accurate risk modelling than the commercial banks? I presume that is what you mean.

Lisa Jacobs: Yes. We have been in business for about 13 years, and we are entirely focused on small businesses, SMEs. Our average business has about 10 employees, has been trading for about 10 years and has about £1 million to £1.5 million in revenue. We have built our risk models very much around that customer base.

We collect as much data as we can. We use our data and technology in a similar way to traditional finance providers. The checks are very rigorous, but we are pulling data from multiple sources to build what we call a data lake, which is a big database. That enables us to make accurate decisions. The more data we get, the better.

Q119 Danny Kruger: That is a very different approach from the one Theodora is describing, which is more relational and involves actually visiting the businesses.

Lisa Jacobs: Our average loan size is about £80,000 or £90,000. We have a very quick process. Businesses apply in six minutes, and we have pulled lots of data on that to make it as easy as possible. Because our business owners are also the sales director, the finance director and the



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marketing director—they have six different jobs—we make it as quick as possible.

We combine that with a human approach. There is an account manager they can speak to. In most of the reviews we get, people talk about speed and ease, and the relationship that they build with their account manager through that process.

Q120 Danny Kruger: Only once the computer says yes do they get an account manager.

Lisa Jacobs: Some 75% of our applicants get an instant decision. The other thing we have learned is that small businesses like to get a quick answer, even if that is a no.

Danny Kruger: Yes, it is easier. You want to be told no.

Lisa Jacobs: That is and continues to be important for our small businesses.

Q121 Danny Kruger: Andrew, can I turn to you? We have heard about those two quite different approaches. Both are making strong claims about the accuracy and value of their approach. Do you recognise a difference from how you work?

Andrew Harrison: If you look at NatWest, we are serving everything from start-up businesses through to large plcs. We do both. If you are a small business wanting to borrow up to £50,000, we would predominantly do that digitally. Our experience is quite similar to what Lisa described. You can go from application to approval within 10 minutes and get funded within 24 hours. For lots of small businesses, speed is important.

We also have the largest network of relationship managers across the UK. We have 1,100 relationship managers, who work with businesses on the ground and help them with their business plans. They do that in more of the way Theodora is talking about in terms of understanding the business, understanding the management and working with them on their financing proposals. We do both.

Q122 Danny Kruger: I understand. We have listened to Theodora talk about the way the US system works. What do you think when you hear that banks over there are required to work with CDFIs and other intermediaries? Would there be some value in doing that in the UK?

Andrew Harrison: One of the real changes we have seen over the last 10 to 15 years is more choice and competition in the market. There is a place for every type of financing. CDFIs do a hugely important job.

Separately, I am the chair of a charity, NatWest Social and Community Capital, which does just what Theodora was talking about. We work with social enterprises. The bank provides us with capital to do that.

Q123 Danny Kruger: That implies that the bank recognises that there is a gap



that needs to be filled by alternative providers.

Andrew Harrison: The whole market needs to be served. No one organisation or institution can serve the whole market. It needs to be done through a lot of different providers doing different things with different risk appetites.

Q124 **Danny Kruger:** Mikael, this is perhaps for you. Andrew, you might want to comment as well. Can I ask you both about the BBRS, the system for resolving disputes? What do you think about the performance of that system? We had very high hopes for it, particularly for small businesses. Has it delivered? Have we done the right thing by essentially giving control of this dispute mechanism to the banks themselves?

Mikael Sørensen: We have not signed up for the BBRS. We did investigate it when it was launched, but we came to the conclusion that only very few of our complainants would be eligible for the BBRS. It was less than 10%. In the first place, we have very few complaints. That is the reason why we have not signed up for it.

Q125 **Danny Kruger:** Is the system as a whole satisfactory? It might not be appropriate for you.

Mikael Sørensen: It is difficult for me to answer that question.

Q126 **Danny Kruger:** Andrew, presumably NatWest is signed up to it.

Andrew Harrison: It is, yes. The BBRS was established post the Walker review to provide alternative dispute resolution to slightly larger businesses. My perspective is that it has worked very hard to do that. It was set up absolutely independently from the banks. There are seven lenders that are signed up and supporting it. Although it is funded by the industry, it is completely independent.

It has been subject to independent reviews to establish whether it is operating independently and whether it is delivering against its purpose. Both those reviews have been very positive about it. I have no concerns about how it is operating.

Q127 **Danny Kruger:** I have one more very general question. It would be interesting to hear from each of you, but only if you feel like you have something you want to say about it.

Is the lack of equity finance for businesses generally, and small businesses in particular, a problem for our country? Debt seems to be much more available. Does this have negative consequences for our economy and for the small business growth we want to see? What do we do about it?

Lisa Jacobs: There are probably challenges in both debt and equity. While you were out of the room, I mentioned the well-documented gap in small business lending of about 7% to 15% on an annualised basis. There



are things we can do in the debt space to tackle that, and I will come on to that in a second.

When it comes to equity, there are areas where we are very well served, such as seed capital and VC. The venture capital community in the UK is very strong, particularly in London. There are pockets outside of London where it is much less well served. There are things that the British Business Bank is doing around that, for example, such as the growth funds and the regional funds, which are very important.

Q128 Danny Kruger: It is not very patient either. Do you recognise that?

Lisa Jacobs: Yes, this is about long-term patient capital. The Mansion House reforms are talking about addressing that. It is an important part of the overall economic support for small businesses and all the way through to larger businesses. Yes, I am very supportive of what we can do to support that whole financing area.

When it comes to debt, there are some policy things that we can do to support the debt provision. Theodora mentioned the recovery loan scheme. That is due to end in June 2024. This has been a really important way to support small businesses in getting access to finance. We would be very supportive of a longer-term Government guarantee, similar to what the US and Germany have. We used to have a smaller version of that under the enterprise finance guarantee. It will be really important to make sure that there is either an extension or a long-term guarantee there in debt financing as well.

Theodora Hadjimichael: We are not in the equity space so I cannot specifically comment on that, but I would love to reiterate my earlier points. From our perspective, there is a really big problem around accessing debt finance and small loans under £100,000 for small businesses looking to grow. Especially since the Covid schemes, we have seen that there is a real scarcity of longer-term affordable finance for very small businesses.

To reiterate the point around the recovery loan scheme, it is hugely important: 80% of CDFI lending is guaranteed by RLS. A lot of the really excluded groups, like women, ethnic minorities and businesses in low-income areas, tend to have less security. Property values are lower in more deprived areas. It is really important not only that the guarantee is extended but that it is extended very soon. It is ending in six months. For business planning purposes, we need assurance and continuity a lot sooner than June 2024.

Mikael Sørensen: Handelsbanken is not in the equity or venture space either. I have worked in five different countries, and I recognise some of the challenges that we have in the UK from those other markets, especially when it comes to venture and equity financing for smaller start-ups. There is definitely something that can be done there, but it is not a space that we are in.



Q129 **Danny Kruger:** You are suggesting that other countries that you have worked in have a better balance of equity and debt.

Mikael Sørensen: I recognise some of the challenges that we have in the UK in that space from other markets.

Danny Kruger: I see. This phenomenon is international.

Andrew Harrison: I would perhaps come at this from a slightly different direction. If you look across the different equity providers, venture capital firms, angel networks, etc. there is equity out there. To Lisa's point, outside of London and the south-east, it becomes scarcer. It is easier to find here than it is outside of London and the south-east.

I would tie this to business support more generally. There is a lot of business support, but it is very fragmented. For businesses to get the support that they need to help them build a business plan, which will allow them to access equity, can be quite challenging. Our research would say that only 5% of businesses find support that they implement that then helps their business grow and be more successful.

There is a lot out there, but it is difficult to navigate. There are a couple of things that flow from that. There is a lot of grant funding. We believe there are around 1,000 different grant schemes across the UK, but it is hard for businesses to find the grant scheme that is relevant for them at that particular time and apply for it. Some businesses are doing that, but many are not. How can we make it easier to navigate?

We have accelerator programmes across the UK. We work with higher-growth businesses. One of our roles is to try to connect those businesses to the equity providers. Intermediaries can work to bring together smaller businesses with equity and make it easier for businesses to find the funding they need. It would be worthwhile for us to put some time and energy into thinking about how we might do that better.

Danny Kruger: That is very interesting. Thank you all very much.

Q130 **Keir Mather:** I just had one final question, if that is okay. It is quite a general one. When the Governor of the Bank of England visited us recently to give evidence, he provided his assessment of the health of SME lending overall. He said, "Given what has happened"—this is the context of inflation and high interest rates—"this could be much worse. They are seeing some signs of pick-up in arrears, and some signs therefore of some problems emerging. The banks, for their part, are therefore quite cautious about lending at the moment, but there is not a block on lending".

I was just wondering whether any of you could provide an assessment of the Governor's comments. Do you agree with the assertions that underlie the recent evidence he gave to us?

Mikael Sørensen: We see an increased number of arrears and customers coming into difficulties. Anything else would be quite strange.



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In our bank, we do not see anything worrying. As I said earlier on, we are almost at the same level today in terms of new lending as we were a few years back before coronavirus hit us.

We do not see any knock-on impact in that sense, but some of our existing customers definitely need a little more help and attention today than they did a couple of years ago.

Lisa Jacobs: We have seen a very resilient loan portfolio. A lot of the small businesses I speak to are very resilient—60% of them think that has improved through the pandemic. We saw a uniform manufacturer pivot to become a face mask manufacturer; a gin distributor that had sold through restaurants and hotels started to sell directly to consumers. We see this huge resilience and entrepreneurship within our small business community and among the small business customers we have. It has been very resilient. That has been down to this huge resilience and the way we do credit assessment.

There is a huge amount more choice and competition in the market than there was five or 10 years ago. That is definitely true over the period I have been close to small business financing. That is really important for addressing these blockers. There will be banks and lenders that take different views on different businesses. As long as choice and competition continue to encourage that, we will be in a much better place than we might have been.

At an aggregate level, there is still more we can be doing to get finance to small businesses. Small businesses drive growth in the economy. They are 60% of private sector employment. They have a huge impact. While there is not a block per se, there is more that could be done.

Q131 **Keir Mather:** To pivot back to a question I asked Andrew earlier, is there a particular form of SME that lenders are most risk averse when looking at? Does there need to be a change of mindset in relation to backing SMEs that could contribute real value?

Lisa Jacobs: If you look at surveys historically and today, smaller businesses do tend to struggle. It is not that hard to work out why. If you think about the data there is for small businesses, it is very sparse. Like I was saying before, it is quite difficult to do those credit assessments. It is costly. It is a costly process to underwrite a small business versus a consumer, where it is much easier. The average loan size is smaller so the margin on it is smaller.

It is more costly to do, and you make less money from it. It is not surprising that there is a gap here. That is why businesses like ours or alternative lenders that use much more technology and data in the process are really filling that gap in the market and working alongside the other participants here on the panel.

Q132 **Chair:** I want to conclude by asking a few questions from the perspective



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of, let us say, someone in my constituency who wants to start a small business. What one sentence of advice would you give to someone who wants to start a microbusiness? You must all have at least one word of advice.

Mikael Sørensen: The way it works in our bank is that you would go down to the local branch.

Q133 **Chair:** Where would they find that?

Mikael Sørensen: We have 158 branches across the country.

Q134 **Chair:** Is there one in Worcester?

Mikael Sørensen: We have one in Worcester, yes. You would go down to that branch.

Chair: It is a physical building.

Mikael Sørensen: It is a physical building, yes. We are very welcoming. We have open doors to anyone who would like to walk in. We are typically not on the high street, I have to say, but we have physical buildings with real people sitting in them.

You would go down there and have a chat with the local manager about your business, your prospects and your needs for lending or other kinds of banking services. We do not use credit scoring in the bank. A real person will examine the credit you are applying for.

Q135 **Chair:** By definition, this is a start-up, perhaps someone who has never run a business before. Andrew, what would you say? They are not going to be able to find a branch of your bank, are they?

Andrew Harrison: We have 547 of them, so there are quite a lot. They would either go into a branch—

Chair: They could go into the branch. It is interesting that you have both mentioned going into branches.

Andrew Harrison: That is one option, and it is a good one. We also have what we call local enterprise managers, who work out of our branches.

This is the other thing. If I were starting a business, I would look at the wider support network, including the Federation of Small Businesses and the chambers of commerce. I would go along there and go to a networking event. I would take the benefit of the support that is available from those fantastic trade organisations to give you pointers about what you need to do to start a business and help you get networked within that local area.

We then have branches. As I say, we have local enterprise managers who run seminars and suchlike in our branches, and who go out across the community helping provide education around starting a business. We



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have a very extensive digital support package. We have something called Business Builder. In the last year, around 200,000 people have used that Business Builder package. We will provide seminars.

Q136 **Chair:** They could do that if they were not near a branch.

Andrew Harrison: Yes, or they could do both. We tend to find that people do both. They might go to a branch; they might go to an event; they might go to the Federation of Small Businesses; and they might then access some of our stuff online. That will help them develop the information that they need to start up.

Theodora Hadjimichael: CFDis, like Andrew said, typically hit the pavement. They do networking events at chambers of commerce and other local events. They talk to businesses and give advice. A lot of our members provide start-up loans.

Q137 **Chair:** Would it be easy for someone to track down a representative from one of your firms?

Theodora Hadjimichael: In some areas, it would be. Again, we do great work, but we want to grow. We want to have national coverage. We need investment and support from the Government to drive that, but that is the ambition. There is coverage in a lot of places.

Chair: They could google you.

Theodora Hadjimichael: Yes. The motivation is to be local, to be in person and to give that face-to-face support. Our members provide start-up loans to the British Business Bank. They are big delivery partners of the BBB. Some of our members support start-ups that do not fall within the parameters of the start-up loans scheme. They support start-ups as well. That face-to-face networking and getting local support is really important.

Q138 **Chair:** Is the start-up loan scheme that you are referring to the one that you administer or the British Business Bank's one?

Theodora Hadjimichael: The British Business Bank has a start-up loan scheme, for which CDFIs are delivery partners.

Q139 **Chair:** You will be part of the national network delivering that. For Funding Circle, people presumably just look online.

Lisa Jacobs: We are online, yes. For businesses that are starting up, there are start-up loans and the networks that are there. As those businesses grow and think about the different finance options, like Funding Circle, they can find us online, yes.

Q140 **Chair:** We had evidence from the Federation of Small Businesses that one of the biggest concerns for its members is that businesses that are starting up get asked for personal guarantees. What are your firms' policies on personal guarantees? Do you invariably ask for them? Do you sometimes ask for them? What is your policy?



Lisa Jacobs: We ask for personal guarantees.

Q141 **Chair:** You do. What are they secured on—a home?

Lisa Jacobs: The personal guarantee is a commitment by the individual to guarantee the loan. In some instances, it can cover their home. We have never foreclosed on somebody's personal home, but you might take a charge on it or something. I can understand why business owners do not want to do that. We find that the presence of a personal guarantee decreases losses significantly.

Q142 **Chair:** You ask for a personal guarantee 100% of the time.

Lisa Jacobs: Yes, outside of some of the Government loan schemes.

Q143 **Chair:** Is it the same for everyone else?

Theodora Hadjimichael: I would echo a lot of the points that Lisa made, but there is a bit more nuance. For very small loans, start-up loans and social enterprise loans, CDFIs do not take personal guarantees. They very widely do take personal guarantees for larger loans.

In the last session, there was a lot of talk about proportionality. That is really important. First, there should be proportionality around the affordability of personal guarantees, so that it forms part of a wider package. Secondly, there should be proportionality in terms of transparency. It should be very clear in the legal language what the business is signing up for.

Finally, there should be proportionality in enforcement. CDFIs look at personal guarantees on a case-by-case basis. If the worst possible thing happens to the business, they will look on a case-by-case basis at whether it is realistic, affordable or the right thing to do to call in that personal guarantee.

Mikael Sørensen: We normally provide secured lending.

Chair: You lend against something.

Mikael Sørensen: For instance, that might be against bricks and mortar. It is very rare that we ask for a personal guarantee. I will not say that it does not happen, but it is very rare.

Andrew Harrison: For us, it is a mix. Sometimes we are very similar to Mikael. When we are lending to a larger business that has assets, we would not always ask for a personal guarantee.

I would just add a couple of things about the small business segment. Some 63% of our customers are sole traders. If you are a sole trader, you are already personally liable. The personal guarantee is for the minority of businesses that are limited companies. It is a smaller proportion of our book.



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We would ask for a guarantee, but we would not take a charge on any personal property or a personal home for loans under £50,000. For that small business group, we will take a personal guarantee if it is a limited company, but not if it is a sole trader. We also would not take a charge on a personal property in that case.

Q144 **Chair:** Finally, on the role of the regulator in all of this, you will be aware that the Prudential Regulation Authority is planning to bring in changes known as Basel 3.1. For people out there listening, that will involve reducing a supporting factor, which means that you will have to hold more capital against lending to small businesses. How is that going to affect your lending book? I will start with the biggest firm, which is NatWest.

Andrew Harrison: We have some concerns about Basel 3.1 in this context. The research suggests that the additional capital that the industry would need to hold is something around £44 billion. You are taking capital out of the sector that would be supporting small business lending. Therefore, due to the additional capital that needs to be held, it is likely that the price will go up and it will become more expensive.

Chair: That £44 billion is across the whole of the UK economy.

Andrew Harrison: It is across the whole of the UK, yes.

Q145 **Chair:** Are you able to share with us what you think the impact will be on your firm?

Andrew Harrison: From our perspective, we have our view on that. We will have to hold more capital. It is probably not something to share directly, but we can do that outside the session, if that is helpful. The general point is that all lenders will have to hold more capital. Because of that, lending is likely to become more expensive.

The other thought we have, which we think should be given some consideration, is that banks in Europe are not following the same trajectory on this.

Chair: The US has delayed again as well.

Andrew Harrison: We just need to consider what that means around the competitiveness of the SME sector.

Q146 **Chair:** You are making representations to the regulator about that.

Andrew Harrison: Yes.

Chair: Are you as well, at Handelsbanken?

Mikael Sørensen: I would echo what Andrew is saying. It will mean that we will have to hold more capital when we lend to SMEs. The SME supporting factor means we can hold one-quarter less capital than we could if it were removed.



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Another part of Basel 3.1 is that the PRA is proposing to maintain a 100% risk floor on lending secured with commercial property. For many SMEs, that is the kind of collateral they can provide to the bank. It incentivises them to go for unsecured lending rather than secured lending because the risk weight for unsecured lending will only be 85%. It is a bit illogical to require a higher risk floor for secured lending than unsecured lending.

Chair: You have also made those representations to the regulator.

Mikael Sørensen: Yes, absolutely.

Q147 **Chair:** The regulator thinks it will increase competition because firms with internal models will be able to compete more effectively rather than using the standardised model. Does that make any sense to you at all?

Mikael Sørensen: Yes and no. We are in the process of applying for an IRB licence, but we cannot get a landing slot with the PRA because it does not have enough resources. We are not the only bank that is in that position. For us it will only make life worse, if it is implemented as proposed.

Chair: That is very interesting. Do you recognise that picture at NatWest?

Andrew Harrison: That is right. When you are looking at choice and competitiveness, it could have more of an impact on the newer challenger alternative funders than on the high street banks.

Chair: It will have more impact in terms of making things worse for them.

Andrew Harrison: Yes, because of the amount of capital that will need to be held.

Q148 **Chair:** So it damages challenger banks relative to incumbent banks. Does it affect either of your business models?

Lisa Jacobs: We are not directly impacted by that because we are a platform. We do have banks who lend through us and access small businesses through our technology platform. It does not directly affect us.

When we are thinking about policy overall, we need to make sure that there is an encouragement of choice and competition and a level playing field across traditional banks, new challenger banks and alternative lenders, such that we can, as an ecosystem, provide across that. Basel 3.1 does not affect us, but there are other ways that we could think about the level playing field. We should think fintech first or alternatives first when setting policy.

Chair: You have not made a representation to the consultation, though.

Lisa Jacobs: No.



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Theodora Hadjimichael: Like Funding Circle, this does not directly affect us, but, hearing the banks talk, it sounds like it is going to get more expensive to lend to SMEs. It sounds like there is going to be more exclusion and the existing gap could widen as a result of the regulatory changes. That is really worrying.

It would be really important to put steps in place to counter this so that there is supply from the community finance sector and the alternative finance sector to fill that gap. That means that we need investment and funding into the sector, anticipating some of these changes. We also need to make sure that there are referral mechanisms in place so that the businesses that are excluded can find an alternative lender easily.

Q149 **Chair:** Before I wrap up, are there any things you came here burning to tell our Committee that I and my colleagues have not managed to get out with our questioning?

Lisa Jacobs: I would just make a comment around data. I highlighted data as being challenging in this area. There are further enhancements that we could make to our data-sharing schemes. One of the great things that have happened over the last decade is the UK leading around data sharing.

Chair: This is open banking.

Lisa Jacobs: It is open banking. It is also things like commercial credit data sharing, which has probably had a bigger impact for us. Certain high-level bank data attributes are shared through credit bureaus to lenders in a standardised way. That has meant that challengers or alternative finance providers like us can provide a very quick process.

As I said before, 75% of our applicants receive an instant decision because we can pool these data forms. That enables us to be more accurate in our risk assessing; it enables the customer to have a quicker process; and it enables us to open out in order to serve more small businesses.

We would be very keen to see continued enhancements in that, whether that is directly through CCDS, the commercial credit data sharing programme, to increase data fields, or through open banking. We have made a really great start on open banking, but the data we receive is not necessarily always consistent because each different lender might have a different way of categorising data. It is quite tricky and challenging for us to ingest and use that data.

In terms of the consent, we need to enable small businesses to continue to provide that feed to lenders. Over time, that means they get served better and they get better options, because that data enables other lenders to provide them with great financing offers when they need it.

Chair: Are there any other last points on that?



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Theodora Hadjimichael: This is not specifically on data, although that is a really good point. I would like to make one last call to action. The gaps in SME finance have been so persistent over time. You saw it in the last review. In some cohorts, it has got worse. We did not touch specifically on ethnic minority businesses or women-led businesses today, but these are particular groups that really struggle to access finance and are being declined at higher rates.

It does not have to be like this. We have the ability to change that and to get more funding to businesses like Miss Macaroon and the roofing company. The research out there shows that between 100,000 and 200,000 businesses are discouraged or declined each year. A portion of those are viable. They could be Miss Macaroon; they could be the roofing company. They could be real drivers of the economy.

NatWest is doing great work on the consumer lending side with some of our CDFIs. Another high street bank is going to make an announcement about investing into CDFIs soon. More of that needs to happen.

There are key things the Government can do as well around extending their recovery loan scheme and providing some of the risk capital to enable that kind of lending. It is within our gift to change this. It would make such a huge difference to so many small businesses and so many local economies around the country. It is so important to drive these changes, so that in a few years we see these gaps declining.

Chair: It remains for me to say that I also urge all of you to communicate some of the messages that you have communicated this afternoon out there as well. The average person who is thinking of starting a business in my constituency would not know half of what we have learned this afternoon. We really have learned a lot.

It has been a very interesting session. I want to thank you for the time you have taken in giving your evidence this afternoon.