CONSULTATION RESPONSE

FSB Scotland
Federation of Small Businesses

Economy, Energy and Tourism Committee

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Introduction

The Federation of Small Businesses (FSB) is Scotland's largest direct-member business organisation, representing around 20,000 members. The FSB campaigns for an economic and social environment which allows small businesses to grow and prosper.

Small businesses are the backbone of the Scottish economy – SMEs represent 99% of all Scottish businesses and provide 53% of all private sector employment.

The FSB is pleased to submit its comments to the Economy, Energy and Tourism Committee on its inquiry into the way forward to Scotland's banking, building society and financial services sector.

We note the range of questions set by the committee. The FSB's submission focuses on the first four questions covering the impact of the financial crisis.

1. Impact and the Availability of Credit

It is clear that the turbulence on the world's financial markets had an effect on small firms who do business in the real economy. At the height of the financial difficulties the most pressing concern was that, across Scotland, perfectly viable small businesses faced serious cash-flow issues, compounded by a lack of affordable credit. By October 2008 our members told us that they had begun to cut back on 'non-essential' spending (advertising, training, capital investment). In December 2008, 20% indicated that they had had to reduce employee numbers; this had risen to 31% of employers in a recent survey.

Since October 2008, the FSB has regularly surveyed members to track the impact of the recession, including access to finance. A more detailed survey was undertaken in January 2009 by the Business School at The Robert Gordon University.

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Key points from this work are:

- Data collected at the start of December 2008, based on the previous two months, indicate that this was the worst trading period for small businesses, with 64% reporting a decrease in trade. In August 2009 this figure has reduced to 47%, with 22% reporting an increase in trade.
- An increase in payment times (from invoice to full payment) reached its peak in October 2008, with 41% experiencing increases. Since then this has held steady at approximately a third of businesses reporting an increase in payment times.
- Around 30% of businesses consistently report an increase in the cost of existing credit (such as loans or overdrafts).
- In the January survey, 22% reported that fees for overdrafts and loans had increased, with 55% saying the bank had not requested additional security, while 9% reported that it had. 32% reported that their bank had been less helpful.
- In August 2009 67% of businesses reported they were not confident about the future prospects of their business, while 31% were quite confident – a slightly more optimistic response than was received earlier in the summer.

The FSB welcomed the publication in July 2009 of the Scottish Government's SME Access to Finance study. It found that there was a significant gap between the demand for finance from Scotland's small businesses and the willingness of high street banks to provide it.

Anecdotal evidence suggests that, while availability of funding may have eased, businesses continue to report an increase in fees and charges by banks.

Despite many small businesses having very modest turnovers, small business banking attracts a range of charges and fees not seen in the competitive personal banking market, including, for example, charges for paying money into an account.

In addition to substantial increases in arrangement fees for finance (with higher interest rates applied) as well as increased fees for renewals of existing overdrafts - essentially businesses are expected to pay for simply agreeing to continue an existing arrangement - and maintenance charges for unused overdrafts, businesses have recently begun reporting that banks are finding new ways to charge. In particular we have received complaints from businesses about banks asking for large sums of money as security for the use of credit card facilities by businesses. These sums can represent 10% of turnover or transactions and the business is given a short period of time to stump up the cash or have card facilities withdrawn, the money taken automatically from the account, or the account closed. The sudden influx of complaints on this issue to the FSB suggests a definite change in policy from banks, despite claims that this has always been standard practice.

2. Impact of Initiatives

In October 2008 the FSB called for a Small Business Survival Fund to help businesses cope with the sudden and severe shortage of finance. In the 2008 Pre-Budget Report the Westminster Government announced a £1bn Small Business Finance Scheme, which went live on 14th January 2009 as the £1.3 billion Enterprise Finance Guarantee Scheme. While certain elements of the scheme could have been improved (particularly around implementation), we warmly welcomed this initiative. On balance, we believe this fund has been successful, although demand peaked quickly.

We also welcomed the flexibility offered by HM Revenue and Customs by the establishment of their Business Support Service. Feedback from businesses suggests this intervention has been exceptionally helpful. Government figures suggest that 12,000 businesses in Scotland had been helped to spread payment of £214m of tax payments since the service's launch in November 2008.

From a Scottish perspective, we welcomed the Scottish Government's lead in speeding up public sector payment times. With cash-flow tight for many businesses, prompt payment for services can be a lifeline, especially at a time when large businesses were extending payment terms to their suppliers to unacceptable levels. We further welcomed moves to pass on prompt payment terms to sub-contractors, though this is harder to enforce.

The reduction in VAT has been less successful, according to businesses. While many businesses saw a cost to adapting to the new rate of VAT (which will be repeated if the planned increase occurs), 99% of respondents to our survey in January 2009 felt the VAT reduction had no impact on their business.

It is also worth commenting on a couple of initiatives introduced elsewhere in the UK. Firstly, the ProAct scheme, introduced in Wales to support the automotive industry and later rolled out to a range of sectors, is regarded as an important step to support SMEs. The scheme can help support short-time working and retain skills in the business. The FSB and the STUC have jointly called for the introduction of a ProAct scheme for Scotland.

More recently, the UK government introduced the Financial Intermediary Scheme in England. This partly addresses FSB calls for a Corporate Mediator to engage with small businesses and banks. In essence, a Financial Intermediary will be supported in each Business Link area to assist small businesses to apply for finance and, crucially, to monitor access to finance and report back to government. The FSB is not aware of any similar function in Scotland.

Some government interventions have therefore been more helpful than others. While significant funding difficulties remain for small and micro businesses, our evidence suggests that the situation has stabilised, rather than continuing to deteriorate. Returning the economy to growth will undoubtedly require additional intervention.

3. Moving Forward

A report published in September 2008 by the Scottish Government highlighted difficulties with SMEs accessing finance from banks. It further commented on the relationship between banks and small businesses. This report was based on findings of the Annual Small Business Surveys of 2005 and 2006, so it is clear that many of these problems existed long before the global financial crisis.

Indeed, the FSB had believed that for a long time that the SME banking market in Scotland suffered from lack of competition. With the new Lloyds group and RBS now responsible for the vast majority (some early estimates suggested 80%) of small business bank accounts, we now have serious concerns about the future of SME banking in Scotland. We are principally concerned that lack of competition will result in small business customers receiving a poor deal from banks.

Furthermore, we are closely monitoring the impact on customer service of bank restructuring plans. Many FSB members in Scotland (particularly in rural areas) raise concerns that decision-making responsibility has been diluted in local areas. In certain parts of Scotland there is a strong sense that an understanding of the local/regional economy (including seasonal/sectoral issues) is necessary to make funding decisions which allow those fragile economies to operate.

The FSB has called on our high street banks to restore decision-making powers to local branches. A poll of FSB members found that small businesses want to have a personal relationship with their bank when obtaining finance. Over half (54%) said they chose to communicate in person with their bank, rather than via letter, online or over the phone, while 86% said they believed decisions on lending should be made by a local branch, rather than centrally.

The same poll found that a majority of businesses are dissatisfied with banks, although they still rely heavily on them. Following wide consultation with our membership, the FSB launched its seven principles of business banking, which we hope high street banks will use when considering finance applications.

The FSB Principles of Small Business Banking are:

- Fix costs on loans and overdrafts for the whole of 2009 if repayments and limits are not broken;
- Pass on base rate cuts in full to small business customers, and don’t change them to LIBOR (London Interbank Offered Rate);
- Make it possible for customers to switch accounts within five working days as written in the Statement of Principles;
- All banks should take part in the European Investment Bank lending programme, along with the Government’s Enterprise Finance Guarantee;
- Consider all reasonable requests for finance from a small business and produce a letter of explanation if refused;

- All documentation and contracts must be clear, fair and not misleading; and
- Finance penalties for the banks must apply where appropriate, if any of the above is not adhered to.

The FSB feels that, while the current financial crisis has made SME finance issues particularly acute, in reality these problems have existed for years. With the ongoing restructuring of banking services, and the loss of a competitive SME banking environment, it is now time to consider whether additional funding mechanisms are necessary to support small businesses in Scotland and return our economy to growth.

The FSB, together with a coalition of community groups and trades unions, has therefore called for the establishment of Post Bank, set up in the Post Office network as an alternative to the big high street banks. This is designed to reverse the trend where the so called 'lower margin activities' of business banking and small loans were de-emphasised. The Post Office currently has a network of 11,500 branches across the UK. While this would not replace traditional high street banks, the creation of a Post Bank could answer the concerns around secure and equitable finance and the future of the Post Office network.

While this would need to be taken forward by the Westminster government, we are also keen to look at how the role of the Scottish Investment Bank could be expanded. At present niche funding for R&D and innovation is unlikely to solve the mainstream financial requirements of small businesses. The potential of additional European funding (through JEREMIE) could open up new possibilities.

We are in no doubt that the relationship between Scotland's small businesses and the banks must be mended as quickly as possible. Entrepreneurs need confidence in order to take risks, innovate and create new jobs. Faith in the banking system is the bedrock for this confidence.

As mentioned earlier, the FSB has recommended the creation of a Corporate Mediator to solve problems and facilitate dialogue in the banking and business community. The FSB proposal draws heavily on the French model, where the mediation service has a 64 per cent success rate in helping viable small businesses access finance.

The FSB proposes that the Corporate Mediator should not have powers to order banks to lend, but be neutral and trusted by all parties. Access to the Corporate Mediator should be free to those small businesses that have been filtered through a rigorous online questionnaire.

4. Conclusion

According to the latest Scottish Corporate Sector statistics, SMEs in Scotland accounted for 1.03m employees in 2008. Comparing these with 1999 figures underlines the critical role played by small businesses as key employers. Small businesses were responsible for an additional 53,240 jobs over the ten-year period, more than off-setting the decrease witnessed in jobs in large businesses (a decline of 24,750) over the same period.

Small businesses will help pull us out of recession but they face particular difficulties accessing finance, which have been exacerbated by the global financial crisis. In Scotland, we are not hopeful that changes in the banking landscape will result in more positive outcomes for our small businesses.

While some government initiatives have been helpful and the situation has clearly stabilised compared to the turn of the year, small businesses continue to face difficult trading conditions and are not confident about their prospects.

While businesses, and not government, will be responsible for a return to economic growth, further intervention will be required and it is now necessary to consider new ideas, particularly in improving SME access to finance and improving the relationship between banks and small businesses.

Small businesses did not cause the banking crisis and it is vitally important to ensure that viable small businesses are able to gain access to credit on reasonable terms as quickly as possible, to allow them to sustain and create employment and move the economy from recession to recovery.