Regional banking and diversity

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Regional banking and diversity – an answer to UK’s banking crisis?

By Dr Daniel Tischer, Alliance Manchester Business School

What is the aim of this report and how is it organised?

The aim of this document is to provide supplementary evidence of the benefits of a diverse and regional banking sector. The research presented here provides a specific narrative in which a diverse and regional banking sector should be discussed. In other words, it argues that UK retail banking suffers from a lack of diversity and that current government policy is not equipped to alter this reality; instead, new entrants to the UK retail banking sector would require different ownership structures and business models to have a marked impact on the sector as a whole. The report is organised in 3 sections:

Part 1 lays out the crisis in retail banking and the remedies proposed by government to make retail banking more efficient. This is followed by a short discussion of why these advertised solutions are unlikely to solve any of the problems exhibited as they do not sufficiently tackle the issue of diversity. Part 2 discusses the history of regional banking in the UK and what remains of a previously diverse retail banking sector, before summarising the perceived benefits of a diverse and regional banking sector. Part 3 compares British and German experiences of change in retail banking structural issues and lending behaviour.

About the author:

Dr Daniel Tischer is a Lecturer in Political Economy and Organisation Studies at the University of Manchester where he wrote his PhD on ‘The Embeddedness of Ethical Banking in the UK’. He has been a fellow at the Social Science Center in Berlin conducting a comparative study on cooperative banking networks in the UK and Germany and has been a Research Officer at the Centre for Mutual and Employee-owned Business at the University of Oxford. Daniel’s research interests revolve around the study of (global) finance and banking from a critical perspective, including social network studies of financial derivatives and ethical banking, retail banking studies and a wider engagement with the mutual and cooperative banking sectors.

The views presented in this paper are those of the author alone, but I am grateful to the Community Savings Bank Association (www.CSBA.co.uk) for their ongoing support and feedback.
Part1: Retail Banking in Crisis

The charges:

UK retail banking is broken. This is not because of the recent financial crisis. Nor is it because of customer inertia to switch bank accounts or barriers to entrance - both ideas promoted by banks and government agencies. It is because retail banking in the UK has changed – from what had once been a diverse sector with a regional focus serving private and business customers, to one that is dominated by international investor interests in pursuit of shareholder value, not public interest.

Despite their recent advertising campaigns to the contrary, banks are no longer interested in the consumer. They have manipulated key financial markets; they have mis-sold products to private and SME customers and advertised free banking when in fact hidden charges make UK current accounts highly profitable. UK banks continue to close branches in rural and urban locations under the pretence that customers have moved online, leaving over 1000 communities in UK with no access to a bank branch.

The promises:

UK retail banks have promised change. After being bailed-out with public money they promised to, once again, serve the public: to provide efficient access to the payment infrastructure, to lend to those who need to borrow, to limit speculation and to make banks safe again. They promised to change how banks operate by reviewing how they engage with customers, their sales practices and by making products more transparent.

The government buys into such narrative by initiating numerous reviews into bank behaviour and competition. The government recognises that competition is failing and that the Big 5 (Barclays, HSBC, Lloyds Banking Group, RBS & Santander) have too much control over the market; however, no aggressive action has been taken so far, despite calls to break up big banks. The government has proceeded by:

1. introducing a updated switching policy to encourage consumers to shop around for accounts that offer a better deal;
2. creating new challenger banks out of the ashes of nationalised assets – these banks are meant to improve the offering for consumers;
3. taking a stand against mis-selling of products to private and small business customers and ordering banks to compensate customers;
4. supporting banks to restore lending to SMEs through the funding for lending scheme, thereby encouraging regional economic activity and employment growth;

The real problem:

The banking industry has found itself on a prolonged rollercoaster ride for almost a decade now. Initially, the dysfunctionality of banking became apparent through the near collapse of the financial markets in which banks were largely involved through their investment banking activities. Banks lost control over their own operations – they simply did not know what their own employees were doing. Intense public and regulatory scrutiny have culminated in the uncovering of persistent and repeated
scandals involving major banks and their mis-treatment of private and SME consumer (PPI and IRHP mis-selling) and at a higher order through the manipulation of LIBOR, FOREX and Silver markets by leading global banks. In the case of PPI, UK banks have collectively paid out £22.2bn between 2011-2015 and are seeking to cap overall claims at £30bn. Mis-selling was eventually attributed to sales targets set to encourage staff to maximise income per branch.

However, and contrary to common wisdom, these scandals are not isolated incidents limited to the involvement of rogue traders, but are systemic failures of a banking industry that has bought heavily into the notion of a shareholder-value driven business model. Investor demands for double-digit Return on Equity (RoE) created a short-term, risk-prone culture within banking in which other stakeholders have been pushed into the periphery. Cost-savings (achieved through branch closure), interest foregone and income maximisation (product portfolio expansion and a sales culture) supersede the need for customer satisfactions, not least to make up for the ex-post costs incurred by settling and reimbursing PPI and IRHP claims, which puts further pressure on the underlying financial performance of those banks.

In light of this, banks promised wide-ranging culture change; yet, thus far there is little evidence of an appetite by banks to follow through on this promise, apart from glossy advertising campaigns. Indeed, the shelving of the review into the “banking culture” initiated by the FCA reinforces the status quo that a true culture change is no longer a top priority.

SME lending, too, continues to suffer from “long standing structural problems [...] dating from before the financial crisis”, although the lack of funding available to SMEs in the aftermath of the crisis has been eased according to “anecdotal evidence (p 102); still, BoE evidence suggests otherwise (ibid pg.6). In particular, the report refers to an inability of incumbent banks to adequately assess and price credit risk of SMEs, thus increasing the cost and availability of capital for SMEs to expand. RBS, the market leader in SMEs lending, is currently under investigation by the FCA for its treatment of SME customers through its Global Restructuring Group, further underlining a culture that categorically mis-understands the needs of its customers.

Collectively, these developments have sparked explicit calls “to foster diversity in financial services sector” by the UK Government in 2010, think tanks and academics. A diverse banking system, so the argument says, is more resilient and more competitive because consumers have more choice, and assets are less concentrated in specific markets and within specific types of institutions with similar goals.

Yet, despite calls for greater diversity, the process itself and the results achieved, are less than desirable. Indeed, Michie and Oughton’s Diversity Index highlights how little progress has been made since the crisis. In 2013, the index itself shows virtually no improvement to the situation in 2009, nor does any of it components (diversity in ownership, funding resilience, geographic concentration and competition) make any substantially advances. Diversity has fared even worse; down over 15% compared to the baseline in 2000now standing at 80-85%. Banking in the UK can be best described as follows: a sector dominated by powerful shareholder interests, with the market-share concentrated in a few London-based banks. Quite the opposite of a diverse sector.
Part 2: UK banking policy and the demise of regional banking

In theory “banking” is a diverse sector with many different types of banks conducting specialist activities – retail, investment, corporate, private banking to name a few. Yet over the past 30 years we have seen the rise of global banks, combining all those specialisms under one roof. This lead to business models of banks becoming increasingly mimetic (Froud et al. 2016). The beginning of this can be traced back to the deregulation of the financial markets in the UK in 1986, in what is known as the Big Bang. The aim at the time was to reduce restrictions on the type of activities banks can engage in and therefore to encourage competition (by increasing the number of firms active in any given market), and to generate economies of scope and scale for banks. A side-effect was that doing so made banks more complex, and in order to manage such complexity, banks have introduced increasingly mechanistic ways to organise their activities, in particular, how they make lending decisions, deal with customers or create new, “innovative” product offerings.

This move has profoundly affected the relationship between banks and its customers, that is, customers’ relationships with banks have become less personalised and subsequently increasingly more standardised. Technological advancements and new methodologies employed to assess the worthiness of a potential borrower (in particular the shift from CAMPARI to purely maths based credit scoring provided by third-parties) have become prevalent. In the UK, relationship banking as a type of bank-customer interaction, in which the branch manager had the final say over lending decisions, disappeared.

The lack of regional banks today is a result of a decades-long failure of policy to retain regional banking. “Big” was beautiful in the eyes of government, business and regulators alike. By scaling up their operations through mergers and acquisitions, banks effectively reduced the number of banks active which led to an increasing concentration of assets and market shares in few banks. First, this had an adverse effect on competition as noted in the many investigations and enquiries ordered by government agencies into competition in retail banking, or more recently with a specific focus on SME lending. Second, most banks operate nationally and this includes most recently established “challenger” banks (TSB Bank and Virgin Money; however Metro Bank retains its focus on the Greater London area).

Yet prior to this, regional banking has been well established. The trustee savings bank movement of the early 19th century established a system of loosely affiliated regional savings banks across the UK. But ambition to scale up operation slowly amalgamated them into a group-like structure from the 1970s onwards, to create what floated as TSB Group plc in 1986. Even the remaining building societies have followed down this path. Building societies were also once local institutions, yet mergers over time have increasingly widened their geographic scope. Nationwide already made its ambitions explicit in 1970 by changing its name from Co-operative Permanent. Other building societies are less forthcoming and retain their regional affiliation (e.g. “Yorkshire” or “Coventry” Building Society), yet are no less operating across the UK. The rise of online banking further eroded a regional character by making it easier to lend to customers outside of the reach of brick and mortar branches; a move that was welcomed by regulators as they considered societies' assets to be too concentrated in regional mortgage markets.
Credit unions and the Co-operative Bank, the sung Hero to challenge the Big 5 after the crisis, have not fared better. Aggressive, inorganic growth has led to the Co-op’s near collapse in 2013 which was followed by a bail-in led by two hedge-funds who are now the majority owners. This has been considered by many to equate a “hostile takeover” by highly shareholder value-driven entities renowned for questionable business practices leading customers to consider switching their bank accounts elsewhere. Since then, the Co-operative Bank has divested assets heavily shrinking the business to less than half its size in 2012 (£51.8bn in 2012 to £22.4bn in 2015). Since 2012, management has focused on stabilising the bank, yet it continues to be loss-making; hence there is limited support suggesting that the Co-operative Bank will have a major role to play in the near future.

Credit unions in the UK tend to be very small financial institutions with different ambitions and sizes under which they operate. Credit union membership in the UK has grown for well over a decade to over 1.2 million and assets stand at just over £1.3bn; however, credit unions are very limited in the type of product markets they can operate in. Lending to local business remains very restricted and has only been allowed since 2012 and thus they remain largely dependent on income generated from loans to their customer members.

Like credit unions, building societies are constrained in the type of markets they can engage with by regulation, but also in many cases for historic reasons. Building societies are predominantly engaged in customer saving and mortgage markets. Few societies offer basic current accounts. Moreover, ambitions to lend commercially are often limited to basic savings and loan products, and commercial mortgages, limiting their competitiveness in SME lending by an absence of business accounts. In any case, lending to non-private customers is limited to 25% of the loan book (75% of loan assets must be secured against residential property). Even if restriction on building societies to lend to business was reduced as demanded by some think tanks, including Res-Publica, renewed competition in the market for business customers may render the ability of building societies to compete unfeasible, especially in the absence of FLS. Besides, given the limited experience of building societies in this market, and the more fundamental aspects of their business models as intermediaries between private savers and borrowers, building societies may remain cautious, if not opposed to, lending to SME, which is considered considerably more risky and thus may push them out of their comfort zone.

Localising alternatives: Diversity and regionality in banking

The lack of a regional banking system in the UK banking sector is made more explicit when comparing the UK to most other developed nations. Regional banks are central features of the banking sectors in many nations, as diverse as Japan and the US, with the latter featuring over 5,400 holding less than $1bn in assets. However, in the US, national banks have become more powerful since the financial crisis, yet, due to the size of the US, few actually operate in every state.

In Continental Europe, regional banks have evolved historically and are traditionally engrained in the social fabric by being owned co-operatively or publically.

In Europe, savings banks are historically publically-owned (see Austria and Germany), often by local or regional governments. Few savings banks are owned “privately”; however, here private
ownership refers to socially engaged consortia of owning interest tied to a specific region, and not to stock-market ownership. In either case, savings banks carry a social mandate to act in the interest of their customers, that is, to provide local/regional access to banking services for the public and to support the local economy, in particular SMEs.

Co-operative banks have been, and remain key players in many European markets. Like savings banks, there is no universal model of how co-operative banks are organised and conduct their business. Having grown out of the Schulze-Delitsch and Raiffeisen-movement in the mid-19th century the co-operative banking movement seeks to counter financial exclusion of rural and city populations alike with specific focus on what we would now consider to be the self-employed and SMEs. “Help to self-help” was and remains the guiding operating principle, meaning that alongside a financially business model, social values and development goals are equally important to assess performance.

Despite differences in ownership, there is a set of common features: profit maximisation is not the exclusive or dominant aim; regional socio-economic development is a key principle; often retained earnings are the main source of capital; a closer relationship between customer (members) and bank; and they tend to cooperate amongst each other within an often centralised and/or federalised system providing mutual support in form of cross-guarantees.

The drive of the neoliberal agenda since the 1980s led to an initial decline of savings banks in many markets (e.g. Italy and Belgium) as they were seen to be relatively inefficient, weakly governed and above all, not subject to the market for corporate control. In other cases, such as Spain, the financial crisis has further eroded the savings banking system. Moreover, the financial crisis has laid bare issues arising from regional political classes’ ambitions to transform larger savings banks institutions into capital market actors engaged in the securities markets through subsidiaries in the US and UK, e.g. German Landesbanken. Nonetheless, in Germany and Austria, ordinary, regional savings banks continue to strive and are recognised to contribute to the countries’ financial stability (ibid), not least by continuing to lend when private banks reduce funds available. Despite this, there is no substantial difference in their performance and efficiency, and co-operative banks are considered systemically less risky than mainstream bank counterparts and contribute to regional growth.

**The Benefits of Local Banking**

One of the key benefits of having banks with strong local links is that they embed the bank in both its regional society and economy and subsequently reinforces a more traditional bank-customer relationship – “relationship banking”. NEF (2012) considers sustainable local economic development to be a particularly strong point of savings and co-operative banks, due to the “intimate knowledge of local people and the local economy” upon which lending decisions are made. This is in stark contrast with commercial banks’ lending decisions made on the basis of credit scoring systems, which whilst assessing the financial viability of borrowers repaying a loan based on long-term behavioural parameters, they fail to develop a more holistic knowledge about the customer. Moreover, because lending decisions are made on the basis of those assessments, local and regional
bank managers in large banks have limited discretion over extending loans, even if they would consider them viable.

A more recent paper by Hakenes et al (2009)\textsuperscript{13} showed that regional banks (in this case savings banks) have a positive effect on local economies and therefore communities, with the effect being strongest in the most deprived communities. Moreover, regional banks may reduce the potential outflow of resources from its region which is often exhibited in national banks. In this light, the concentration of the UK’s banking sector in and around London poses a serious question as to how other UK regions can strengthen their regional economies, as creating regional banks create a strong incentive to prevent capital outflows and thus would spark regional development through investment.

To some extent, the importance of local banking has been recognised in the UK, in part through the ambition to create a bank with a focus on regional lending through TSB Bank and the substantial growth of Handelsbanken, the UK subsidiary of Swedish Handelsbanken. The success of these approaches highlight the difficulties in “transforming” existing banking structures and cultures; in KPMG’s words: “Legacy cultures are always difficult to change”\textsuperscript{14}. Whilst successful at some level, it could be argued that much of this is linked to exceptional marketing; there is very limited evidence that TSB Bank truly operates on a regional level and its ability to substantially alter competition in the SME market may be limited, given it holds only 100,000 business accounts\textsuperscript{15}. Handelsbanken on the other hand has shown that demand for alternative types of banks is strong in the UK. Since 2007, it more than quadrupled its branch network in the UK to now over 200 branches without a strong marketing presence. Word of mouth and strong relationship-building skills appear to respond well with the local customer base; however, Handelsbanken is also in a privileged position to choose its customers carefully. The decision-making power of a local branch manager is likely to be an attractive proposition to SMEs who often find it difficult to have loans approved through mechanistic Credit-Scoring systems.

Still, the strong performance of Handelsbanken to date signals that despite the government’s gloomy message on entry-barriers it is possible to install a different type of banking model. Obviously, Handelsbanken, an established Swedish Bank partly owned by its employees, has resources to do so. However, the specific model employed, one that focuses on locality and customer needs, also represent a refreshing alternative to the shareholder-value driven models that dominate the UK retail banking landscape. In addition, calls to reform RBS into a set of state-owned regional banks\textsuperscript{16}, after it failed so spectacularly in 2008 and had to be bailed out using tax-payers money, have been ignored by the government and instead the return of the bank to the market-ownership proposed highlighted the limits of ambition to create a regional banking system.

In markets such as Finland, Germany and Austria, Co-operative banks, like savings banks, are subject to the regional principle (Regionalprinzip) limiting activities of banks to specific regions. These federalised systems are organised through central institutions providing clearing functions and ancillary products, including insurance or pension planning adhering to the customer-focused principles written into their statute/articles of association.
Overall, banking sectors that feature a diverse range of banks with respect to ownership and geographic focus have been found to have a series of systemic benefits, including (Ayadi 2010 & NEF 2012):

- Positively contributing to the stability of the financial sector by being risk-adverse and long-term oriented;
- Improved competition between banks operating via different business models;
- Value creation in co-operative and savings banks follows the logic of a dual-bottom line under which shareholder value and short-termism are replaced by a need to be financially sustainable and customer-focused;
- Customer-needs focus through more competitive products, better service and longer-term lending;
- In most cases, these co-operative and savings banks operate on a regional basis lending to SMEs based in the local economy, thus limiting capital drain from regions, and well-developed knowledge about the state of local economies;

Banks that are not shareholder-value driven often face criticism for being underperforming, inefficient and poorly governed. Whilst these claims remain widely contested, a key question remains: Is it desirable to have banks that are not strictly profit-oriented? The question is relevant because for savings and co-operative banks systems to be established, maintained and well-functioning, they require public support; not in terms of favours that might distort competition, but in order to be protected from ambitions to transfer ownership and or assets to mainstream competition, as has been the case under demutualization in the UK (1989-2000) and the consolidation of Spanish savings banks during 2009 and 2012.

Overall, there is little evidence that larger banks do better, that is, that they have lower costs compared to smaller banks\(^\text{17}\). Indeed, more recently with the introduction of new regulatory guidelines, dis-economies of scale are increasingly problematic through the surcharge capital requirement for GSIFIs. All large private banks in Germany have a higher cost-income ratio than savings and co-operative banks and comparable RoE in 2014, although profitability fluctuates more widely\(^\text{18}\). Moreover, size is not, by default, a source of sustainable competitive advantage and, indeed, the inability to effectively manage risk within organisations of size has created a number of scandals that imposed huge litigation costs on the biggest global banks to the tune of over £200bn between 2010 and 2015\(^\text{19}\).

All in all, co-operatives have weathered the aftermath of the global financial crisis well, especially given the varying fortunes of European national economies. Whilst it is difficult to generalise at European level, Table 1 (page 9) shows that key financial measures have improved in most cases (e.g. total capital ratios) and sustained or even expanded market shares. This sends a positive signal confirming the idea that co-operatives are stabilising financial markets. In the UK, the picture has been slightly more negative with the failure of the Co-operative Bank in 2013. Building societies have also only had limited success in taking market share from the Big 5 private banks despite consumers becoming increasingly alienated from big banks.

Moreover, Table 1 further illustrates a particular weakness of UK cooperatives and mutuals in SME lending, which is in part link to lending restrictions that were historically restricting lending to SMEs.
Concentration of SME lending in mainstream banks is thus not a product of mainstream banks’ superior ability to serve SMEs but a structural feature in which competition is restricted. Given the important role played by co-operative banks in lending to SMEs elsewhere in Europe and the expansion of their activity since 2008, there is sufficient evidence to support new approaches to SME lending through a regional and long-term oriented banking system provided by customer owned banks.

Table 1: Key financial measures of co-operative sector developments 2008-2014 (selected countries)

<table>
<thead>
<tr>
<th>Country</th>
<th>Total Assets in €mio</th>
<th>RoE in %</th>
<th>Total Capital Ratio in %</th>
<th>Market Share deposits in %</th>
<th>Market Share SMEs in %</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Austria</strong></td>
<td>360.9</td>
<td>9.1</td>
<td>10.4</td>
<td>36.6</td>
<td>38.0</td>
</tr>
<tr>
<td><strong>Finland</strong></td>
<td>75.7</td>
<td>4.1</td>
<td>12.6</td>
<td>33.8</td>
<td>n.a.</td>
</tr>
<tr>
<td><strong>France</strong></td>
<td>2714.7</td>
<td>3.8</td>
<td>10.5</td>
<td>42.7</td>
<td>43.2</td>
</tr>
<tr>
<td><strong>Germany</strong></td>
<td>1024.8</td>
<td>0.1</td>
<td>12.3</td>
<td>18.6</td>
<td>25.0</td>
</tr>
<tr>
<td><strong>Italy</strong></td>
<td>300.8</td>
<td>6.7</td>
<td>12.9</td>
<td>34.3</td>
<td>25.0</td>
</tr>
<tr>
<td><strong>Netherlands</strong></td>
<td>612.1</td>
<td>9.7</td>
<td>13.0</td>
<td>43.0</td>
<td>39.0</td>
</tr>
<tr>
<td><strong>Spain</strong></td>
<td>113.0</td>
<td>7.3</td>
<td>n.a.</td>
<td>5.0</td>
<td>n.a.</td>
</tr>
<tr>
<td><strong>UK - Co-operative Bank</strong></td>
<td>16.9</td>
<td>6.8</td>
<td>8.3</td>
<td>1.0</td>
<td>2.0</td>
</tr>
<tr>
<td><strong>UK - Building Societies</strong></td>
<td>474.8</td>
<td>5.3</td>
<td>n.a.</td>
<td>19.1</td>
<td>n.a.</td>
</tr>
</tbody>
</table>

*Combined Raiffeisenbanken and Genossenschaftsverband
** Combined Credit Agricole, Credit Mutuel & BPCE
*** Assoc. Nazionale fra le Banche Popolari and FEDERCASSE
**** Unión Nacional de Cooperativas de Crédito and Banco de Crédito Cooperativo

Sources: EACB KEY STATISTICS as on 31-12-08 (Financial Indicators); EACB KEY STATISTICS as on 31-12-08 (Cooperative Indicators); EACB_2014_Key_Statistics_001
Part 3: Bank behaviour in times of crisis – British and German experiences of lending during the credit crunch

There is much talk about how banking has changed as a result of a process called financialization. Financialization describes the increasing importance of the financial markets in everyday life since the widespread deregulation in the 1980s increased the ability to “innovate” and drove the growth of financial assets in the markets. Since the financial crisis, criticism of these developments has become more vocal, in particular given that much of these new market functions are not socially or economically useful – that is, the principals of arbitrage and bricolage have produced innovation which is “bound to miscarry” (Engelen et al 2010)\(^\text{20}\).

This development can principally be observed in the changing activities of banks. Using the German example, because it allows a comparison of changing patterns between savings, co-operative and private banks, it is clear that private banks have substantially reduced their exposure to commercial and private household lending as a percentage of the balance sheet since the early 1990s (Fig. 1). In particular commercial lending has seen a dramatic decline as traditional lending has been increasingly replaced with market-based financing. Savings and co-operative banks on the other hand continue to lend to private and commercial customers at about the same level as in the early 1990s.

Source: Bankenverband (2012)

This does not only confirm the claim that savings and co-operative banks are effective and important lenders, but also that they are more focused on long-term sustainability. In other words, those banks have refrained from fully embracing the ever new, often risky and short-term focused opportunities promoted by innovative financial markets. Instead, and in line with what the literature describes as “socially useful”, that is they must bring about a positive social and/or economic change for the public in general, both co-operative and savings banks have limited their balance sheet exposure to debt securities and other assets\(^\text{21}\) to less than a third of their balance sheet (Fig 2). Private banks on the other hand hold more than 50% of assets in these markets, with most exposure given to tradable financial instruments. This makes them substantially more exposed to market turbulences as witnessed during the financial crisis in 2008.
Lastly, co-operative and savings banks are generally very well capitalised and their risk rating, for example, compares favourably (S&P AA- (Co-op); A+ (Fitch) – both stable) with Deutsche Bank’s BBB+/ A- (S&P/Fitch – stable). Even within a global neoliberal institutional background that favours the idea of private banks, co-operative and savings banks do comparatively better if well embedded nationally at the economic and social level.

These findings are relevant because in the UK, lending to SME and business collapsed during the crisis and despite vigorous attempts by the government to encourage lending to business through Funding for Lending, loans to private non-financial business have remained negative and only began to increase again during 2015 once the rules for FLS were changed by the BoE (Bowman et al, forthcoming). This is in stark contrast to unsecured and secured lending to individuals (see Fig 3), which illustrates a much smaller retraction and a quicker continuous expansion. In other words, banks have shown little interest in lending to business in the post-crisis period.

Fig 3: Net Monthly Loan Flow To Non-Fin Corporations, Secured and Unsecured Lending To Individuals (£m)
Yet unlike in Germany, the decline in UK lending to business and SME through mainstream banks has not been balanced out by alternative savings banks or co-operative banks, because they do not exist in the same way and/or are unable/unwilling to enter these markets. A more detailed look at BoE data on net lending flows shows that FLS funding has largely benefitted households with a net lending flow of £17.5bn (of which £14.5bn stem from building societies collectively). Large corporates and SMEs however have not benefitted from FLS initially and it has taken an increasingly restrictive change of policy by the BoE to get organisations lending to SMEs again (Fig 4); still, building societies continue to reduce their exposure to SME lending collectively; although it is worth noting that Cumberland and Yorkshire have been supporting SMEs continuously by extending loans to SMEs.

Still this data clearly shows that the lack of a diverse banking sector produces adverse effects for the recovery of the UK economy, in particular SMEs, through a lack of available and affordable funding. Building societies, which have been promoted by think-tanks to take a more prominent role in financing of business activity, have, at an aggregate level, reduced their lending to business, and not expanded it.

Fig 4: Net lending flows for FLS participants to companies and SMEs 2013-2015

Source: FLS usage and lending data
Evidence of a mass-exodus is limited with prime current account holders having only declined by 10,000 and have been growing by 4,000 in 2015. However, this is a huge shift from a gain of almost 50,000 customers (almost 10%) in 2011/2012.