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National Assembly for Wales  
Economy, Infrastructure and  
Skills Committee  
Access to Banking

Evidence from Cardiff Business  
School and University of  
Birmingham

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Professor Kent Matthews (Sir Julian Hodge Professor of Banking), Professor Max Munday, Dr Annette Roberts, Cardiff Business School. Dr Tianshu Zhao, Department of Finance, University of Birmingham.

We welcome the opportunity to provide information to this Welsh Government consultation on Access to Banking. **The focus of our response is around the issue of bank closures and business, particularly SME impacts.** Here we seek to highlight research findings that are important to the consultation, as well as alerting Welsh Government to planned research on this topic in Wales.

Professor Matthews and Dr Zhao have undertaken research that explores the relationship between changes in bank market and organizational structure, and bank behaviour in relation to the financing and investment policies of SMEs. Their work also embraces changes in the characteristics of the regional banking market and then geographical differences in access to SME external finance. Their work suggests that the loss of bank branches in peripheral regions can work to disadvantage SMEs, in particular, as they seek finance.

Professor Munday and Dr Annette Roberts are collaborating with the Development Bank of Wales to better understand issues surrounding the demand for, and supply of finance to SMEs in Wales. This research has identified difficulties for Welsh SMEs in terms of access to export financing, and then equity financing, and with these issues in part linked to the structure of the financial supply side in the regional economy.

## Existing Research

Regional disparity in bank credit availability for SMEs and micro-businesses is a well-accepted feature of the bank credit market in the UK. The reasons for the disparity are contested. However, closures and restructuring of bank branches, affects the availability of bank credit to micro-firms and SMEs, and then with closures creating both inter-regional and intra-regional variation in access to business credit. In this respect, Zhao and Jones-Evans (2016) report that: *“The rationalization of the branch networks engaged by the major national UK banks has exacerbated the disparity of the branching infrastructure across national space. Those movements have reshaped the UK financial space and have important implications for the participation of banks in the SME lending market including the risk of further marginalization of small borrowers located in, and a continuing decline in the economic and financial power of, peripheral regions.”* p.819

Critically, links between SME borrowers and their banks are predicated on the strength of the role of the Relationship Manager within the bank organisation. Physical presence of bank branches in the vicinity where SMEs are located facilitates the collection and incorporation of social-embedded information by relationship managers for creditworthiness analysis of SME borrowers. Therefore, the loss of branches negatively affects the use of branches for this purpose. Furthermore, institutional developments in UK branch banking have created a geographical concentration in decision-making that is based in the strategic centres of banking institutions. This has worked to depreciate the

importance of tacit and personalized local knowledge in the underwriting of bank credit toward SMEs.<sup>1</sup> Consequently research exploring the geographical dimension of bank credit availability, has focussed on the role of the dissemination of 'soft' information between the SME, the bank branch and then decision making at bank HQs (the latter of which may be far distant from the SME borrower). The removal of bank branches and local relationship managers is a critical link in this chain which can affect the regional differentiation of SME access to credit and also contribute to the geographical dimension of financial cycles in the UK<sup>2</sup>. Indeed branch closures in Wales are a symptom of a trend to concentrate loan decision making to HQs – a trend hastened by the Global Banking Crisis.

In Wales, relationship banking has been identified as a means of attenuating regional differences in bank credit availability.<sup>3</sup> SMEs developing good customer-loan relationships with their banks found that they were able to maintain lines of credit even in times of financial stress. The maintenance of the customer-loan relationship came at a price often met by the SME. In the case of Wales, relationship banking strengthened loan commitments by geographically varying loan pricing and loan conditions. A mitigating policy is to encourage a form of highly mobile relationship bank manager that is socially embedded in the locality.

The effect of branch closures on the functionality of relationship banking, might not be offset by the application of online-banking systems. For example, Zhao and Jones-Evans (2016)<sup>4</sup> examine the geographical segmentation of bank credit to SMEs in the UK. It is found that SMEs located in areas with higher branch density and with branches that have a shorter distance from their bank HQ, faced lower credit constraints during times of financial stress. **The centralisation of banking corporate lending decisions have then had a deleterious effect on bank credit availability in areas furthest from the bank HQ.** In the digital age distance should not matter for the transmission of financial information and therefore should not affect bank credit allocation. The evidence, however, suggests otherwise. Zhao et al (2019)<sup>5</sup> find that distance has no effect on the transmission of hard information in the availability of certain types of bank credit (household mortgages) but does have an impact in the case of lending to SMEs.

## In summary

Bank branch closures in Wales are expected to impact upon SME access to credit. Critical here is the loss of local information relevant to SME loan and credit applications. It also affects the competitiveness conditions in the credit market faced by SMEs in Wales. All of these eventually lead to an outcome on the real economy. Unfortunately this adds to the challenges facing Welsh SMEs, particularly in more rural areas. Moreover, the pattern of bank branch closures could potentially have more dynamic impacts in terms of shaping SME demand for finance towards non-bank sources. We expect that these issues will be important context for future operations of the Development Bank of Wales in more rural parts of Wales.

In future research we are seeking to better understand geographical patterns of bank closures in Wales, and their effects on the economic growth and production and investment behaviour of firms in the real economy, and also develop a better database of bank branch closures through time in

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<sup>1</sup> Zhao, T., & Jones-Evans, D. (2016), 'SMEs, banks and the spatial differentiation of access to finance', *Journal of Economic Geography*, 17(4), 791-824.

<sup>2</sup> Degryse H, Matthews K, & Zhao T (2018), 'SMEs and access to bank credit: Evidence on the regional propagation of the financial crisis in the UK', *Journal of Financial Stability*, 38, 53-70

<sup>3</sup> Degryse H, Matthews K, & Zhao T (2017), 'Relationship banking and regional SME financing: The case of Wales', *Int. Journal of Banking, Accounting & Finance*, 8,1, 93-118

<sup>4</sup> Zhao T, Luintel K & Matthews K (2019), 'Soft Information and the Geography of SME Bank Lending', Paper under current review, and available on request from the authors.

<sup>5</sup> See footnote 4.

Wales. Here we hope to use resources such as Google StreetMap and new ONS resources to identify the scale of the problem.