



SMEs: building trust in markets and ensuring that they get a fair deal



Foreword by Matt Vickers

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Political and economic events find us in uncertain times. As the Brexit saga rumbles on, we cannot be sure what impact the UK's departure from the European Union will have on the country's economy. Certainly, large and small businesses will need to adapt the way they deal with other markets. Business regulation will also be impacted when EU legislation no longer applies.

Whatever happens to the UK economy after the country leaves the European Union, it is certain that SMEs will remain a cornerstone of the Government's economic policy. In

fact, there is a desire across the political spectrum to create an environment where small businesses are allowed to flourish.

At the same time, there are obstacles that prevent small businesses taking advantage of opportunities for expansion or that lead to them becoming weighed down by administrative burdens. This is especially so in a changing regulatory environment.

Many of these obstacles are the day-to-day tasks that, in a large company, are the bread and butter of a back-office facility, but in a small organisation can steal vital hours of employee time.

Ombudsman Services works closely with microbusinesses across sectors including the energy and communications industries, and witnesses firsthand some of the challenges they face within these markets. Our experience has shown that small businesses often behave like consumers, facing the same threats but without the

same protections. With this in mind, we have conducted some research into what small business owners experience when dealing with suppliers and the impact of the quality of that service.

Our findings make interesting reading. We can see the struggles of small businesses when they seek prompt and proper payment, the difficulties they face when trying to switch a supplier, and the complexity of navigating service brokers. The challenges small businesses face with their suppliers reflected in our survey's findings, with for example, 30% of SMEs believing they get a worse deal in comparison to domestic (non-business) consumers when procuring and using services such as energy, telecoms and water.

However, these obstacles are not insurmountable, and there are also immense opportunities for helping SMEs find a way through. This is something we are giving thought to at Ombudsman Services. For example, we are looking at the work of the Financial Conduct Authority (FCA) – which increased the number of SMEs able to access strategic redress in financial services – to understand whether their approach can be replicated in other sectors.

If SMEs are to continue to be a staple of the British economy post-Brexit, we must improve protections afforded to SMEs, including the right to redress. Doing so will allow them to flourish and drive growth.

This paper is designed to kick-start a debate and a discussion process about supporting SMEs, to pose questions and to seek input from others to come to an informed conclusion about how to support SMEs in the economy of the future.



Overview – How does the SME experience differ from the consumer

The challenges SMEs face are, in many cases, similar to those faced by consumers, but the protections they are given are not. This can leave SMEs feeling as though they do not get a fair deal.

From April 2018 to April 2019, microbusiness consumers made up 9% of the total cases Ombudsman Services dealt with in the energy sector. Of those microbusiness cases, approximately 2,227 (56%) involved a billing complaint and 597 cases (15%) were related to sales. For consumers, billing is consistently the main type of complaint we handle and through strategic redress we can offer adequate protections. We cannot always do the same for SMEs.

Ombudsman Services are currently restricted by the definition of a microbusiness consumer:



Fewer than 10 employees
(or their full-time equivalent)



Less than €2 million turnover

An annual turnover or annual balance sheet total not exceeding €2 million



>100,000 kWh



>293,000 kWh

Energy restriction

A company which has an annual consumption of electricity of not more than 100,000 kWh, or gas consumption of not more than 293,000 kWh

As a result, Ombudsman Services are restricted from offering support to SMEs which fall outside of the criteria outlined above, despite them facing the same concerns lodged by microbusinesses and consumers. Below we detail a sample of the main issues faced by SMEs:

Poor payment practice

Poor payment practice is one of the biggest causes of dispute that Ombudsman Services deals with across markets. Big businesses across sectors use their dominant position over SMEs in the same way they exploit consumers: issuing unreasonable payment terms and prohibitive penalties for late payment.

There is, however, a difference in the way domestic and microbusinesses are treated when it comes to debt management. Licence conditions require suppliers to help domestic customers at the first sign of trouble, but the focus is on collecting payment for microbusinesses, with warrants and disconnections being sought more quickly. This can serve to exacerbate the problem as a business unable to trade will be unable to pay bills.

Switching

Microbusinesses are increasingly trying to switch suppliers and are coming up against problems when the new supplier takes over. If the service transfer fails it can result in the business being charged uncompetitive deemed rates with the previous supplier. When a microbusiness is in debt and the supplier refuses to offer new rates and/or refuses to let them leave, original fixed term contracts allow suppliers to charge 'out of contract prices' which consumers have not agreed to and have no control over. This affects consumers and microbusinesses alike and needs to be addressed.

Polling of 208 SMEs in May 2019 by Consumer Intelligence on behalf of broadband ISP Onecom, found nearly two thirds (65%) of the sample considering switching services over the next 12 months. One third-party intermediary (TPI) has suggested that regulators should enable SMEs to delegate authority to TPIs to switch them between suppliers to reduce the burden of switching.

Brokers

One area which also puts SMEs at great risk is in relation to brokers. Complaints about brokers made up roughly 10% of microbusiness complaints in the last year. However, as Ombudsman Services have no remit to protect consumers and businesses who procure their services through brokers, customers can be left without the option of strategic redress. Brokers frequently compare contract offers to inflated deemed prices, misleading businesses into thinking they're getting a good deal.

Many microbusinesses are unaware of the significant differences between fixed and deemed contracts, expecting that it will operate like the domestic market. If a consumer takes a complaint about a supplier to an ombudsman with a broker involved, the supplier will blame the broker. This leaves the ombudsman unable to take the dispute forward against the broker.

Similar issues, different protections

The lack of protection makes SMEs vulnerable. Just as consumers in vulnerable circumstances are often unaware of how or when to take a complaint to an ombudsman, some SMEs are not even given the choice.

Micro business consumers make up 10% of complaints we handle. But this leaves a vast number of SMEs not covered and without the right to a redress scheme. Some SMEs are vulnerable and at risk of being exploited due to the existing definition, nonetheless, the definition cannot be cast too wide either, as this would not be fair to suppliers. For example, one definition of an SME is if it meets two out of three criteria: fewer than 250 employees, a turnover of less than £25m, gross assets of less than £12.5m. This definition would be far too broad.

Ombudsman Services invites regulators to work with us, using our data and insights to find the right criteria that's fair for SMEs and suppliers.

Why SMEs will form the backbone of the UK's post-Brexit economy

SMEs form the backbone of the UK's economy, and need to be provided with the right protections to be able to realise sustained growth. It is vital that policies and infrastructure allow SMEs to get a fair deal and grow whilst being protected from the threats they face.

SMEs and the UK economy:

99.5%

SMEs account for at least 99.5% of the businesses in every main industry sector.

- Between 2000 and 2019, there has been a sustained growth in the business population by 2.2m. This represents growth of 63%.
- Total employment in SMEs was 16.3 million; 60% of all private sector employment in the UK.
- The combined annual turnover of SMEs was £2.0 trillion, 52% of all private sector turnover.
- Small businesses accounted for 99.3% of all private sector businesses at the start of 2018 and 99.9% were small or medium-sized (SMEs).
- SMEs are crucial for innovation and productivity growth and have disproportionately driven job creation since 2010.

The Competition and Markets Authority (CMA) estimate that SMEs overpay on energy bills by approximately £500m a year. But, given current guidelines, only a small proportion of these small businesses have access to an ombudsman.

SMEs post-Brexit success:

- A recent study published in the journal *Regional Studies*, has found well over one million SMEs, around a quarter of the total, are concerned about how Brexit will affect the success of their business.
- It is also essential that in a post-Brexit economy the SME market is as attractive and inviting as possible. Redress and ombudsman provision for SMEs will only help to further build trust in the SME market, encouraging more entrepreneurs to set up businesses.

To help ensure SMEs are able to thrive, we need to ensure that the operating environment they exist in does not throw up additional barriers to growth, allows SMEs to focus on running their businesses and ensures that they do not have to engage in lengthy and costly legal disputes. These challenges can be crippling for the smallest SMEs.

SME business leaders

current view of the market

In August 2019, Ombudsman Services commissioned Deltapoll to conduct a national survey - gathering the views of SME leaders on their experiences with service providers in the energy, telecoms, and water sectors.

The sample size for this Deltapoll survey was 639 SMEs. Of these, 507 were classified as small sized organisations (i.e. less than 50 employees) and 132 were classified as medium sized organisations (i.e. 50 to 249 employees).

Has your business experienced unfair treatment or poor service when procuring and using any of the following services?



17%

Overall, 17% of SMEs claimed to experience unfair treatment or poor service

when procuring and using services in the telecoms [e.g. broadband, mobile landlines, phones, etc.]

Generally speaking, what kind of deal do you feel that SMEs currently get in comparison to domestic (non-business) consumers when procuring and using services such as energy, telecoms and water?

- Only 26% of SMEs are confident that they get a fair deal compared to domestic customers when procuring and using services such as energy, telecoms and water, compared to 30% of SMEs believe they receive 'an unfair deal' in comparison to domestic (non-business) consumers.



23%

Only 23% of SMEs classified as small believed they received a fair deal

in comparison to domestic consumers, in comparison to 38% of medium sized SMEs who believed they received a fair deal.

Do you feel that SMEs have adequate protection from any unfair practices by energy, telecoms and water providers and intermediaries such as brokers and price comparison websites?

- Over half [54%] of the medical & health services sector and 42% of the transportation & distribution sectors felt they do not feel their business has adequate protection from unfair practices by energy, telecoms, water providers, and intermediaries such as brokers and price comparison websites.
- Only 13% of SMEs in the IT & Telecoms, and Media/Marketing/Advertising/PR & Sales sectors felt they have adequate protection from any unfair practices by energy, telecoms and water providers.

% feeling they have adequate protection from any unfair practices by energy, telecoms and water providers:



19%

of SMEs with under 50 employees



26%

of medium sized organisations

Do you think your business would benefit from additional support when looking to resolve disputes with its suppliers?



41%

41% of SMEs agreed (voted "yes") that their business would benefit from additional support when looking to resolve disputes with its suppliers

- 59% of SME respondents in the legal sector, and 55% of SME respondents in the medical & health services sector believed their business would benefit from additional support when looking to resolve disputes with its suppliers.

Creating a conducive operating environment for SMEs

– including the FCA as a case study

Last year the Financial Conduct Authority (FCA) consulted on the definition of SME with regard to access to the Financial Ombudsman Service (FOS). From 1st April 2019, the FCA expanded its definition to enable more SMEs with a complaint about a firm that is regulated by the FCA to be eligible to take their complaint to the FOS.

This new definition is a significant widening – previously, only micro business (fewer than 10 employees and an annual turnover or balance sheet of less than €2 million, ie similar to the current Ofgem definition) could complain to the FOS. The move to the wider definition to include more SMEs was in recognition that SMEs face many of the same issues as domestic consumers as they do not have the financial management or legal resources to take complaints forward if there isn't access to free independent redress. The FCA estimates that widening the definition in this way will enable an additional 210,000 SMEs to access free redress via the FOS.

The new definition covers any SME that falls below all of the following thresholds:



**An annual turnover of
£6.5 million**



**An annual balance sheet
below £5 million**



Fewer than 50 employees



Ombudsman Services case study: Requirement for clarity in tariff calculations

A microbusiness owner was persuaded by a sales broker to agree to a market tracker tariff. The broker explained that the tariff price would be 'adjusted twice a year as the wholesale prices and other charges change accordingly'. They became suspicious when prices only every increased; when wholesale prices fell, their tariff didn't reduce but when they rose, their tariff increased.

A complaint was raised and escalated to Ombudsman Services. The energy supplier told Ombudsman Services that it tracked against Ofgem's Supplier Cost Index. When we investigated, we determined that the prices applied to the account were not unreasonable. We also accepted that Ofgem's Supplier Cost Index was a legitimate way to track the market.

However, the metric against which the market would be tracked was not made clear during the initial sale or in the supplier's terms and conditions. Furthermore, the price increase letters set out that the supplier was tracking the market against wholesale prices, transportation costs, and renewables levies – not specifying Ofgem's Supplier Cost Index. We could see why the consumer perceived that the market was not being tracked correctly.

Industry rules require that suppliers bring the principal terms of a contract to the attention of a microbusiness. We determined that the vague information provided during the sale and in the terms and conditions meant the supplier had not made a principal term sufficiently clear. Accordingly, we determined that the supplier should release the microbusiness from the contract.

We were able to help this microbusiness, but there are many other small businesses who go through the same dispute without the ability to raise it to the ombudsman. Leaving many SMEs unprotected and vulnerable, due to an arbitrary cut off point in the current guidelines, does not benefit consumers, businesses or the economy. Action to resolve this must be taken urgently.

In its consultation, the FCA noted that financial services disputes often coincide with cash flow stresses and other threats to the business. In these circumstances, the cost and speed of redress is often critical to an SME's ability to stay in business. It is therefore important that the ombudsman is able to get to grips quickly with their case and the FOS has made significant investments in its systems and expertise to allow it to do this.

Giving SMEs greater access to FOS, coupled with increasing the award limit for complaints from £150,000 to £350,000, creates confidence in the essential relationships many small businesses have with financial operators, helping them to believe they are getting a fair deal and allowing them to operate comfortably in the market.

The FCA's decision was welcomed by the industry it regulates and we believe that this response would be echoed in other sectors. Suppliers want to help the SMEs they serve and thus the British economy; they just need guidance from regulators to do so.

Whilst the eligibility criteria for FOS should not be followed in every sector, the systemic factors behind the FCA's decision exist across other sectors.

At Ombudsman Services we will be building on the work done by the FCA to share best practice across sectors to kickstart analysis from other regulators on what a similar change could mean. The expansion of the eligibility criteria in which SMEs can receive dispute resolution services from ombudsmen must be carefully calculated and tailored on a sector-by-sector basis.

Takeaways from our insights and data

Through working closely with SMEs and consumers, Ombudsman Services have collected first-hand evidence on the nature of complaints most frequently filed in the energy and communications sectors. Data was collected over the period January 2019 to August 2019.

As you can see, consumers and SMEs share the same problems, in fact in the communications sector they are practically identical, but as this report has shown SMEs are not afforded the same protections. Ombudsman Services is looking to tackle this problem head-on and we will now present our recommendations.

In Energy

SMEs [3,200 cases accepted]

Reason for complaints



Consumers [35,000 cases accepted]

Reason for complaints



In Communications

SMEs [1,350 cases accepted]

Reason for complaints



Consumers [10,500 cases accepted]

Reason for complaints



Recommendations for policymakers and what can be done

- 1.** Regulators need to consider reviewing their definition of microbusinesses / SMEs that are entitled to free redress. The FCA decision was in recognition of the similar issues that both consumers and SMEs face, but outside of financial services SMEs are left unprotected and unable to resolve disputes that can cause them serious financial stress and in extreme cases, go out of business.
- 2.** Lord Tyrie, Chairman of the CMA, recommended that consumer protection be prioritised in competition policy, by the government and regulators. This should be extended to SMEs that face the same threats as consumers.
- 3.** Regulators should work together to establish best practice towards SMEs to allow them to flourish in their respective markets. At Ombudsman Services, we will facilitate this process and help other regulators to learn from the FCA's experiences.

Recommendations for suppliers and what can be done

- 1.** Let's work together to help SMEs, use our data and insights that are available to see where SMEs are having problems, respond to them and develop trust. Not only will this allow you to retain them as customers, but by letting them operate more effectively in the market they will eventually turn into better and more reliable business partners.
- 2.** Post-Brexit we need to support our economy in every way possible. Allowing SMEs to act confidently in markets by giving them the protections they need. This will allow them to continue to drive innovation forward will be essential in mitigating any economic damage from leaving the EU. We don't need to wait for regulators to act first, suppliers can take their own actions to protect SMEs and enable them to access redress before the complaint needs to be taken to an ombudsman.



If you would like to discuss how SMEs can be offered greater protections in more detail, then do let us know. In the first instance please contact **David Pilling**, Head of Policy and Public Affairs, Ombudsman Services on **dpilling@ombudsman-services.org**

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