The future of business banking for SMEs

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INTRODUCTION:

While digital banking in the retail space has transformed over the last decade to offer consumers highly-personalised, seamless experiences, digital banking for SMEs has struggled to make the same progress. Not only is this frustrating from a customer experience perspective, it also makes it harder for SMEs to access financial products that may be critical to their business.

The Covid-19 pandemic and subsequent economic effects have intensified the need for small businesses to access finance in a fast and convenient way. Unfortunately, it appears that the much-needed digital transformation in banking has not progressed enough to save thousands of businesses who may have survived with some short-term support.

SMEs represent a huge market, generating around $850 billion of annual revenue for banks—a pool expected to grow by approximately 7 percent annually over the next seven years. At the same time, the volume, variety and variability of these businesses has made it difficult to create banking services that meet all their needs.

Much of this comes down to a lack of insight. Banks need to offer personalisation at scale, balancing the specific needs of their customers with the internal costs of measuring, monitoring and the risk of servicing them. To that end, banks have traditionally provided a wide range of services to meet the needs of particular segments.

The advent of inexpensive cloud hosting, APIs and digital experiences provide new market entrants the ability to enhance the SME banking experience. A key reason behind the explosion in the use of challenger banks and Fintechs among SMEs is that they have specifically targeted the challenge of customisation and focused on using data and technology to streamline their processes and customer experience.

In a time where [it has never been easier to change banks](), it's imperative for incumbents to prioritise process optimisation and CX if they want to succeed. As risk within the SME market grows, providers need better understanding of the businesses they're building products for. One key to this is embracing a new way of approaching KYB (Know Your Business) – one rooted in fast, comprehensive and real-time digital strategy.

In this report we'll examine where current services are falling short, which businesses are excelling, and how banks can leverage current technology to win this valuable prize.

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Chapter 1

The state of the SME market

SMEs account for approximately 99% of private companies, turning over a collective £1.9tn every year. It is also a growing market, with over 750,000 new businesses created annually.

With the economic damage caused by the global lockdown, SMEs will play an essential role in driving recovery – particularly as they account for more than half of most countries' GDP, and are responsible for nearly seven in every 10 jobs.

While this presents a significant opportunity for financial service providers, technical and legislative limitations have prevented any one provider from creating a single standout offering.

The origins of traditional SME banking

While SMEs have much in common, their specific banking needs vary greatly according to industry, capitalisation, lifecycle stage and business model. It is this complexity that has led most banks to take a pragmatic approach to service offering, based on grouped needs.

SMEs also present greater risk than larger businesses due to limited capital and security. To mitigate this, banks must follow rigid credit scoring models and processes which make it slower to open accounts or lend, particularly when it comes to new entrepreneurs.

Banks are also limited by the technology available, which impacts their speed and efficiency and raises the cost to serve small businesses. The chief reason for this is a lack of investment in new tools. As one executive quoted by Forrester puts it:

"Small and mid-sized business clients account for more than half the revenue we see compared to retail customers, yet we only budget about 10% of our digital spend for anything having to do with digital services for our business customers."

How much is the SME market worth?

According to EY, the SME market generates c.£14bn in banking revenue and 10%–15% return on equity (ROE). Despite the limited capital behind many businesses, there is also a willingness to pay for services targeted to their needs. Adaptivelab found that 55% of entrepreneurs were definitely happy to pay more for services that free up their time to focus on their business. The challenge for banks is unlocking the value of this market while effectively managing risk, efficiency and scope.

Chapter 2

Market trends in SME services

Historically, large banks were the only institutions able to offer the core services for SMEs at scale. However, technology has allowed new challengers to take individual services from banks and scale them digitally.

Generalisation or specialisation

A core example is external finance – a key need for cash strapped businesses. A bank would once have been the default choice for SMEs thanks to a combination of brand equity, strong balance book and domain expertise. But in recent years, more specific services have sprung up to offer a range of ways for businesses to raise finance, including fast-growing Fintechs such as iwoca, Funding Options, Capitalise, Market Invoice and Funding Exchange.

Challenger banks are now explicitly targeting SME customers from incumbents. Laurence Krieger, Tide UK CEO explains: “UK SMEs have been underserved by the traditional banks for decades, with the services offered being a combination of consumer and corporate products that are not fit for the unique and diverse needs of SMEs. While in recent years the bigger banks have worked to bring in services that look and feel like those offered by the challengers, competition still falls short of where they should be for today's small businesses. Challengers, like Tide, are agile and have built a digital-first proposition, meaning we can quickly iterate, innovate and adapt to our members' needs, continually moving our product offering forward. The bigger, traditional, banks don't have the infrastructure to allow them to be this nimble and therefore it will take them much longer to offer the same level of user experience." Meanwhile, iwoca claims to have overtaken HSBC and Santander in the small business overdraft market in the UK.

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>
> Laurence Krieger - CEO, Tide UK

The global adoption rate of Fintech by SMEs sits at 25 per cent currently, but an EY survey suggests by the end of 2020 that could rise to 64 per cent.

The new face of banking

Banks are now realising they need to change their approach, especially when it comes to controlling the end-to-end customer insights journey.

Whereas earlier decentralised service models might lead to customers working with separate community, commercial, personal or wealth divisions for personal and business, these new approaches prioritise sharing of insights and holistic service delivered through technology.

Digital onboarding, for example, is no longer a box-ticking exercise. Developments in KYB mean we must now see it as a living, breathing part of an all-digital approach. Where it was once one part of a wider Know Your Customer (KYC) strategy, it now stands out on its own as something that needs to be maintained throughout onboarding and beyond.

5 benefits of transforming your customer onboarding and risk selection.

Find out how the likes of Santander, Newable Finance, and Innovate UK have reduced onboarding times from weeks to days, hours, or even minutes.

Download our guide

This is evident amongst incumbents launching new approaches to SME banking, with the common focus being on integrating new technology.

- Instead of rebuilding their SME banking service, RBS has started from scratch by launching a standalone Digital SME bank (Mettle)

- Barclays has split its risk, taking a stake in successful alternative finance provider MarketInvoice and also launching new SME funds to support additional lending.

- Santander has taken a marketplace approach, building an open digital financial services platform for SMEs offering services across trade finance, supply chain, payments, and foreign exchange.

Case study

Adapting in Practice: Santander

Santander has been a leader in retail banking for years and sought to mirror that success in its corporate offering. The primary challenge to scaling this service was the highly manual onboarding process, which was time consuming for customers, delivered unreliable response times and seldom yielded the right insights to accurately assess risk.

In order to remedy this, it decided in 2019 to transform its onboarding process through end to end digital integration. By automating key parts of the compliance process, Santander aimed to differentiate itself from other incumbents through fast, convenient customer service.

In collaboration with leading Fintechs, it streamlined AML, KYC and KYB processes, while delivering a digital-first experience through dynamic forms and e-signatures. This new digital system reduced onboarding time from seven days to just 15 minutes, when compared with the traditional in-branch process, and reduced analysts’ time spent looking over documentation by 80%.

Chapter 3

What do SMEs want from financial services?

The chief challenge of SME banking is that needs can vary greatly by lifecycle stage, industry and size. Most incumbent banks make decisions about SME services at the portfolio level, grouping similar customers to balance risk and efficiency. This means that decisions are based on broad criteria and not personalised to the business.

The power of customer intelligence

The core limitation behind this approach is lack of customer insight. Risk is a complex calculation for banks, based on a wide range of data points, many of which are either acquired from the customer themselves, or from research by internal analysts. A balance must be found between what the bank needs to know and what they can practically ask from a customer or afford to discover themselves.

Because of this approach, it's expensive to personalise offers for small businesses because the necessary information is gathered manually. Incumbents end up focusing on providing a range of services to fit a range of SMEs, rather than using data to offer the precise services a business needs.

> The biggest challenges for us are getting quite a lot of information from customers in the most efficient and user friendly way. It's a long onboarding journey, we need to comply with a lot of regulations.
>
> Joseph Connolly, Product Manager, Mettle

The SME onboarding Journey

Insight gathering is traditionally front-loaded into the onboarding process, a key time for winning or losing a customer. Recent research shows that 38 per cent of UK businesses have chosen to abandon a banking services application in the last year due to "slow due diligence processes."

In an interview with DueDil, a Senior Financial Crime expert explained that the traditional onboarding process for banks would usually involve answering between 80 and 120 questions. While many of these questions are essential for compliance, 84% of businesses have had a bad experience of business Know Your Customer (KYC) processes according to Reuters.

The result is that banks often have a limited picture of who their SME customers are and can struggle to offer the right products through their lifetime, limiting ROI and retention.

The top barriers to bank finance for 'would-be borrowers':

- Discouragement (47%) (put off by bank)
- Assumed they would be turned down and so did not apply (30%)
- Process of borrowing (typically the hassle or expense) (29%)

[Source: Ipsos MORI]

Customer knowledge creates lifetime value

Small business owners need their bank to provide targeted solutions based on their business needs, but their needs change over their lifetime. While business needs start relatively simple, greater scale creates needs beyond the expertise of the entrepreneur.

With increasing complexity in their needs, more businesses look for external advice to support their growth. However, rather than looking to their bank for support, larger businesses are more likely to choose an external financial specialist.

This points to revenue that could be accrued by banks but is lost due to a lack of the right customer intelligence and up-to-date knowledge.

DueDil Insight: Denis Dorval, COO

“Transformation is driven by hyper-targeting, meaning the ability to hyper-target specific segments based on behaviour. In the consumer space this means companies can interpret digital trails to understand the ‘behaviour’ of the consumer and then hyper-target. This creates digital consumer experiences which tie specific behaviours to specific propositions at the right time and in the right context.

This same approach is well under way in the B2B market with small and medium enterprises. In a B2B context the concept of ‘digital trails’ is slightly different. Where the consumer is leaving digital trails through the consumption of free digital services offered by the likes of Google, Facebook, Amazon etc. SMEs are leaving digital trails through company websites, social profiles and other information captured digitally and made available through publicly accessible sources.

In this case, the idea of customer behaviour morphs into the concept of ‘company insights’ that can be tracked to specific SMEs. Building an insights-based view of what an SME does and how they are performing – in real-time – allows for the same kind of hyper-targeting that is successfully engaging consumers.”

Case study

Creating long term value: Funding Options

Funding Options was founded in 2012 to expand SMEs access to external financing by connecting them with appropriate lenders. Eight years later, it has lent more than £300 million and can arrange a loan in minutes.

Key to its value proposition is the use of automated proprietary systems to match and score services and applicants. This allows it to accurately assess risk and customer needs quickly and connect them with a provider that suits their profile. This system relies on a combination of human empathy-based skills, its brokerage team, and automated data processing to create a complete picture of a customer to find the best option.

By connecting to DueDil's API, it has radically shortened the customer onboarding process. Taking just 10 data inputs from the customer, Funding Options can instantly ascertain the risk level of a customer by drawing on external data sources. This approach also yields increased long term value by enabling its team to re-sell financing options to customers over their lifetime as their needs change, based on new data that indicates whether the business fits one of their lifecycle borrowing profiles.

Chapter 4

The modern banking ecosystem: data & technology

In the modern financial services market, a bank's brand is now less important than the insight and experiences they leverage. At the international Bank Governance Leadership Network (BGLN) conferences held in 2019 participants highlighted two key focus areas for future success.

- Improved data management
- Responding to changing customer expectations

In the age of customer experience, customer intelligence is now the chief currency for delivering a standout service. The stark truth is most banks are not currently equipped to deliver a service of this kind. According to a report by the Financial Conduct Authority (FCA) many banks are still running legacy systems, with nearly 50% of banks not upgrading old IT systems as soon as they should. This puts them at a distinct disadvantage.

The modular financial services market

Fintechs entering the financial services market have developed innovative service models that reduce operating costs, increase revenue and margins. The offerings of these challengers include traditional banking products as well as other business services, such as invoice management, payroll support, tax preparation, and inventory management.

In a survey of North American SMEs, McKinsey & Co found business owners see ecosystems as a way for them to save time on administration tasks so they can devote more time to their core business activities.

Some challenger banks have made ecosystem integration a key feature. Following the example of API-enabled cloud accounting software such as Xero, banks like Tide provide and connect financial data to 3rd-party apps across financing, HR, payroll and business reporting. In this scenario, the bank becomes the common factor in the financial ecosystem, rather than an ecosystem in its own right.

> Banks typically think of how they can manage the value chain front to back themselves. In the new world banks will need to allow partners to operate within their value chains. This is a fundamental change for banks….I see partnership and partnership agreements as fundamental to the future of banking.
>
> Mike Kennell, Director, Open Banking & Digital Transformation at PwC

What does ecosystem success look like?

There is strong evidence that ecosystems will be an enduring part of the financial landscape.
The technology industry has already embraced them with leaders such as Microsoft AppSource, AWS Marketplace and Salesforce App Exchange generating huge value.

Large financial services companies are joining forces with technology companies to combine the information the latter holds on businesses and individuals with their own financial expertise. Amazon is working with Goldman Sachs, Google has partnered with CitiGroup, and ride-sharing company Uber has launched a comprehensive range of financial products for its drivers called Uber Money.

This points to a new route forward for banks: leveraging their size, scale and profitability to augment the technology and data of their digital competitors. McKinsey suggests three approaches:

- Participate: Banks can provide financial services to at-scale competitors that are building ecosystems from bases in other industries.
- Orchestrate: Banks can also become the primary integrators of partnerships and thus reduce the scale of investment and complexity of execution.
- Build: Banks can build new businesses within and across ecosystems.

While the routes chosen will depend on the available capital, technology and partnerships, there remains a core need for a hub for SMEs that can unite their financial experiences.

> A wave of Fintech ecosystems is making it possible for SMEs to access a wider range of financial products that are cheaper and more tailored to their requirements. This unbundling of financial services means smaller businesses can now turn to a growing number of providers that can offer them the same seamless digital experience we expect as consumers. And they are doing so more and more.
>
> Justin Fitzpatrick, CEO, Duedil

The path forward

The future success of incumbent banks will depend on their ability to make better use of data and technology to improve the customer experience. The current model suggests three main areas of change for banks going forwards:

- Customer expectations
- Regulators
- Underlying business model

From the customer's perspective, there will be an expectation that financial services providers are available whenever they need them and in the way that they need them. This will require greater investment in automation and easy-to-use digital platforms.

Legislation like Open Banking will force banks to be more open and transparent with their customer data. SMEs are increasingly willing to share their data in return for a better range of offers, with 89 per cent of small businesses happy to share their banking data. Banks will need to find a way to turn this to their advantage,

This leads to the evolution of the banking business model. While challenger banks have made connectivity a feature of their model from the beginning, incumbents will need to catch up. As ecosystem partners continue to focus on developing best-in-class solutions in an ecosystem, banks can choose to compete directly across multiple services lines or give customers more convenience by connecting the services they need.

Whatever route banks take, their key asset will always be customer intelligence. Whether connecting apps or running their own ecosystem, banks need to be able to bring key information sources together to understand the complete financial health of their customers.

This will require:

- Investment in Open APIs to guarantee the efficient flow of data between platforms and customers.
- Widespread implementation of automated straight through processing to improve speed and accuracy across KYB checks and onboarding, enabling customers to engage with a bank instantly while balancing risk.
- Reliable data partnerships to expedite data gathering for decisions and track customer lifecycles across ecosystems.

In all scenarios, the customer must remain at the heart of the value-delivery process. By leveraging the right insights and technology, banks can be the focal point for new financial service providers.

About DueDil

Founded in 2011, DueDil is a company intelligence platform that delivers insights on every UK and Irish company and the people behind them.

DueDil provides customers with a complete view of the UK and Irish market so the SME onboarding process is as robust as it is frictionless. All of these insights are delivered by a single KYB for Life platform that ensures compliant onboarding, efficient risk assessment, better pricing and proactive risk monitoring.

In 2020, DueDil was named RegTech Partner of the Year for the second year running at the British Banking Awards in recognition for its work transforming the digital customer journey for tens of thousands of UK SMEs.

DueDil has a number of well-known clients, including Santander, Metro Bank, Funding Options and TSB Bank.