

WHITE PAPER

# SME BANKING:

## Intelligence – Not Applied

Exploring the disconnect between  
banks and SMEs in digital finance



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# INTRODUCTION

According to the International Finance Corporation, small and medium-sized enterprises (SMEs) make up 99% of the 125 million companies in the world, and these SMEs contribute a staggering 49% of global GDP. Despite the market size, banks are in danger of missing this opportunity by not properly addressing this highly lucrative and accessible market. SME customers currently feel that services targeted at them could be better aligned with their specific needs. Banks, by focusing on understanding their business owner customer and providing more-targeted products, will be able to withstand competition from digitally-savvy challenger providers.

Despite the emergence of digital disruptors in the banking sector, the additional competition presents banks with an opportunity to take the initiative and leverage their long-established relationships with SMEs, though they will need to act quickly.

In the current economic climate, the existing relationships between banks and SMEs are not quite what they once were. According to recent data from the Bank of England, the value of outstanding SME lending fell by almost one-fifth after the financial crisis. Whether or not SMEs are less reliant on credit, the traditionally strong credit relationship – the bedrock – between bank and business customer has dwindled.

To separate fact from fiction, Strands, a leading provider of business financial management technology, commissioned research to understand what SMEs need from a banking relationship and how close banks are to meeting those needs.

Over 200 SMEs and banks serving in excess of 1.3m SMEs were surveyed. The research, the first to directly compare banks and SMEs perspective on business banking, uncovers new insights into SMEs' key banking challenges, whether banks are effectively addressing these needs, and how they can bridge the gap to capitalise on the market opportunity.

The research, endorsed by the SME Finance Forum, is required reading for banks looking to lead in this market. The focus, a banking industry that is acutely aware of the importance of digital to SMEs, the challenges on the horizon, but that has to ensure it is firmly on the road to development, to avoid unnecessary loss of business.

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# I. Executive Summary

## How banks can help with SME's future

- An adverse macro-economic climate has created a great deal of uncertainty, especially for SMEs, often the first to feel the effect of economic blows. It will come as no surprise therefore that when it comes to banking, SMEs are looking for banks to help them manage and grow their businesses during turbulent times.
- Financial planning tools and business growth advice, especially money management and cash flow tools are the services SMEs want the most, and they want these delivered digitally. Banks understand this need for money management and cash flow tools, but should now turn their efforts to creating digitally-offered business advice, something SMEs unanimously demonstrated an urgent need for.

## An intelligence gap

- The great news for banks is that SMEs don't doubt their banks' ability to provide good advice. Especially important given guidance is the 'killer app' for banks in this context. The bad news is this intelligence isn't being applied to products and services with SMEs feeling underserved as a result. This is particularly pronounced among micro-businesses that have less faith than their larger counterparts.
- Fulfilling the need for financial management services is paramount for banks committed to catering for their SME clients. Switching bank is easier than ever and with SMEs citing a lack of personalisation as a major reason for leaving, banks need to deliver these services not only digitally, but personalised to the business.
- It is vital that banks understand that fully migrating to digital services is a deal-breaker for SME customers.

## Utility provider not business partner

- The wise move for banks would be to adopt a ‘business partner’ role, rather than one of utility provider. Despite being profitable, transactional services are clearly not what SMEs are looking for.
- Where personalised, financial management services are not provided by banks, SMEs are likely to churn to competitors, especially challengers and Fintechs already embracing digital money tools. They want to compete but are being thwarted by lack of budget, rather than desire to change or less-modern technology.

## A digital future

- Digital is the number one driver for SMEs when selecting a banking provider.
- Digital is no longer a choice for banks, it is mandatory. While banks have digitised transactional services, financial management has been left behind. SMEs are in need of digital financial management tools and would be prepared to pay for them. Banks can simultaneously rescue the SME relationship and create a new revenue stream by digitising financial management.

In the age of Open Banking, where regulation, customer behaviour and new competitors are turning the industry on its head, banks need to address the new dynamics facing the SME sector. Banks need to shift from utility providers to business partners by moving away from transactional services that are commodified and increasingly unprofitable. This need is understood by banks but change is slow.

Banks remain in a unique position. They have access to more information about SMEs than any other organisation. Nobody can rival an SME’s bank when it comes to providing financial advice about their business. And personalised advice, delivered digitally, is the number one priority for SMEs.

Banks have the intelligence, they just need to apply it.

## II. Financial planning for an uncertain future

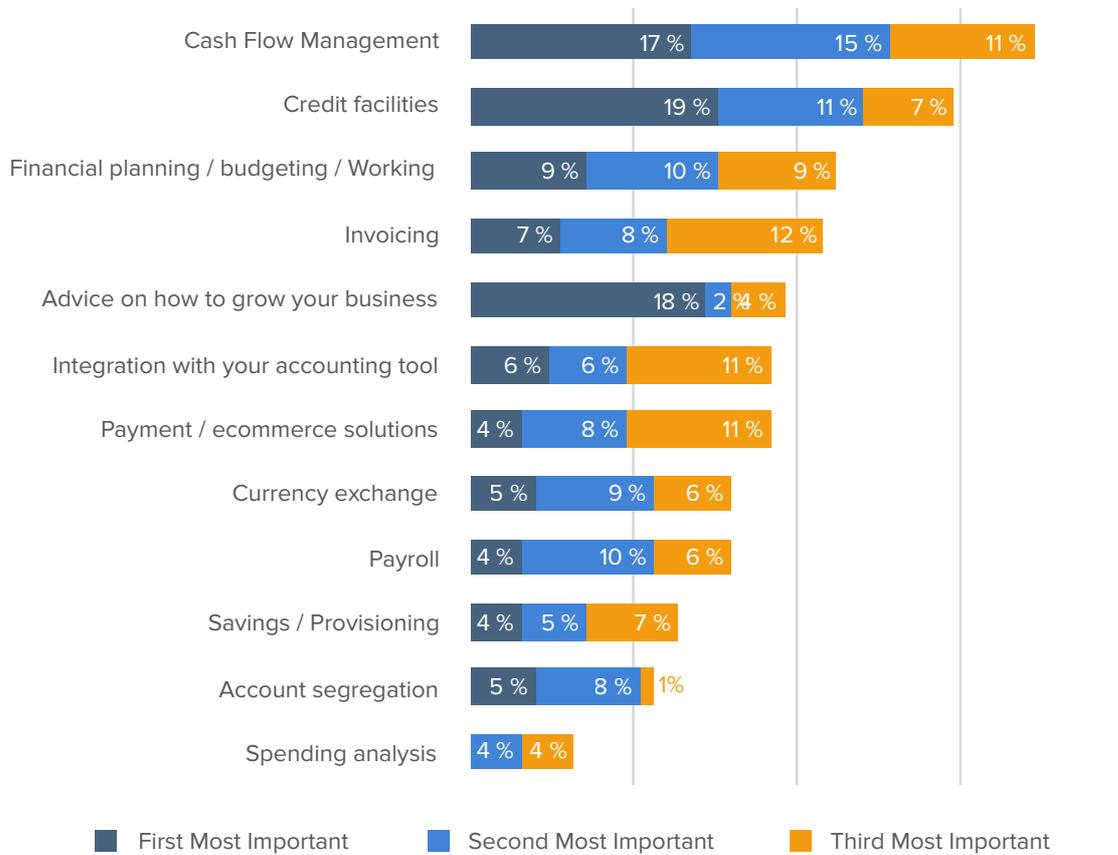
According to research from Ormsby Street and the ONS, only four in ten SMEs are expected make it to their fifth birthday. This is the harsh economic reality caused by myriad issues including low interest rates, flat consumer spending and accelerating inflation. Furthermore, the fate of the Eurozone, especially in regard to Brexit, means that there is a great deal of uncertainty for small businesses.

Banks are under pressure to make more of the relationships they have with their SME clients. Their traditional consumer base sees them as a utility and new challenger banks are stepping in to bring these consumers the services they are demanding. SMEs represent an under-explored market that offers banks the opportunity to replace some of this lost revenue, but they need to act quickly.

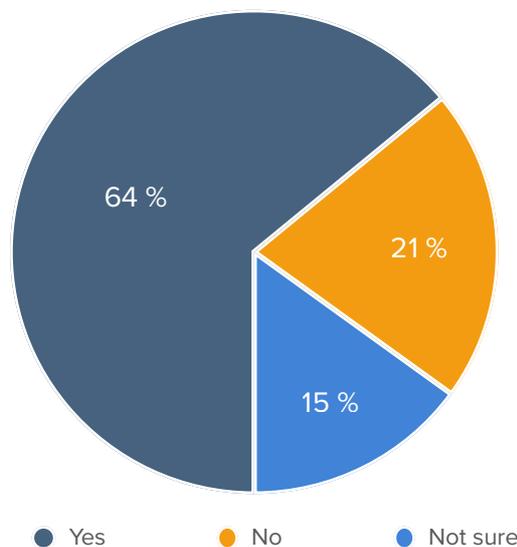
Challenger banks are already encroaching on traditional banks' SME customer base and the mainly transactional services they are being offered are not wholly well-received. So, what can banks do to regain some of the ground lost and begin to be seen as a valuable partner to SMEs?

Unsurprisingly SMEs ranked 'cash flow management', 'credit facilities and 'business growth advice' in their top five financial needs. Clearly, forward-thinking financial planning and advice is critical to SMEs, with 64% requiring financial counsel to run their businesses more efficiently. And 84% of respondents want their planning and advice to be delivered digitally.

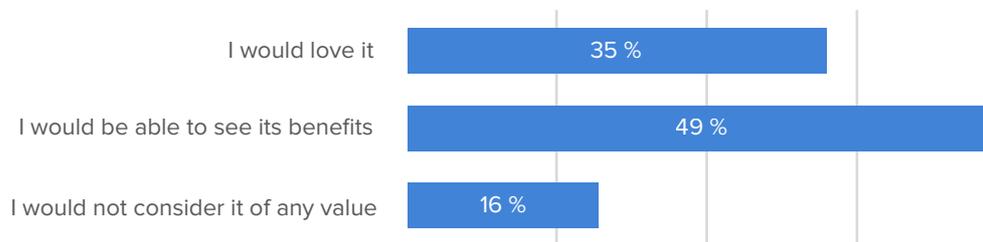
### What are your key digital banking/business finance needs?



### Would you want “money management” advice e.g. cash flow, invoicing or financial planning from your bank on how to run your business more efficiently?



**If you were offered a digital money management solution that helped with everyday business finances such as cash flow, invoicing, financial planning; how would you value it?**



Interestingly this tallies with what banks see as SMEs' key financial needs. All the banks surveyed cited credit facilities and cash flow management as top three needs. However, only a third felt that business growth advice was critical.

Arguably it's simpler for a bank to offer a highly productised service like cash flow management or credit than it is to offer tailored financial planning advice.

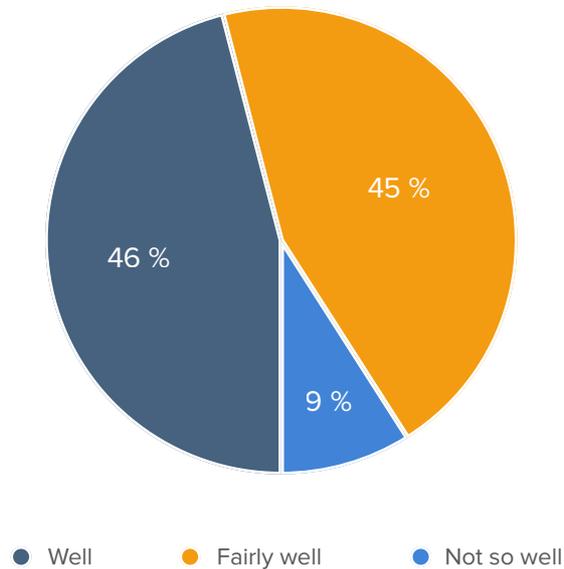
**Key findings:**

- 38% of SMEs ranked 'economic uncertainty' as their #1 macro challenge and 25% cited managing cash flows. Banks are aware, with 50% sharing these two major concerns
- Cash flow management and credit facilities are the #1 financial service needs for SMEs. Again, banks are aware with 66% ranking these as the top three need for their customers
- For SMEs, financial planning and business growth advice is #2 and #5 need respectively
- 84% of SMEs would like this advice delivered digitally
- But only 34% of banks felt that financial planning or business growth advice was a key need
- 34% of SMEs would "love" digital financial planning and a similar number of banks agreed

### III. Intelligence: Not applied

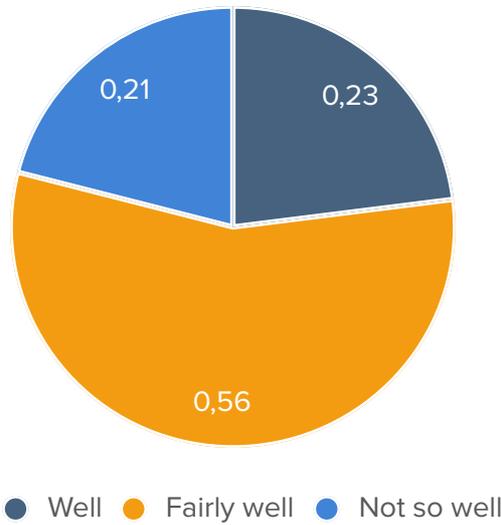
SMEs do not doubt their banks' ability to provide good advice. Nearly half (46%) of SMEs think their bank "understands their financial needs" well, rising to staggering 91% for understanding their needs well or fairly well.

#### How well do you think your bank understands your financial and banking needs?



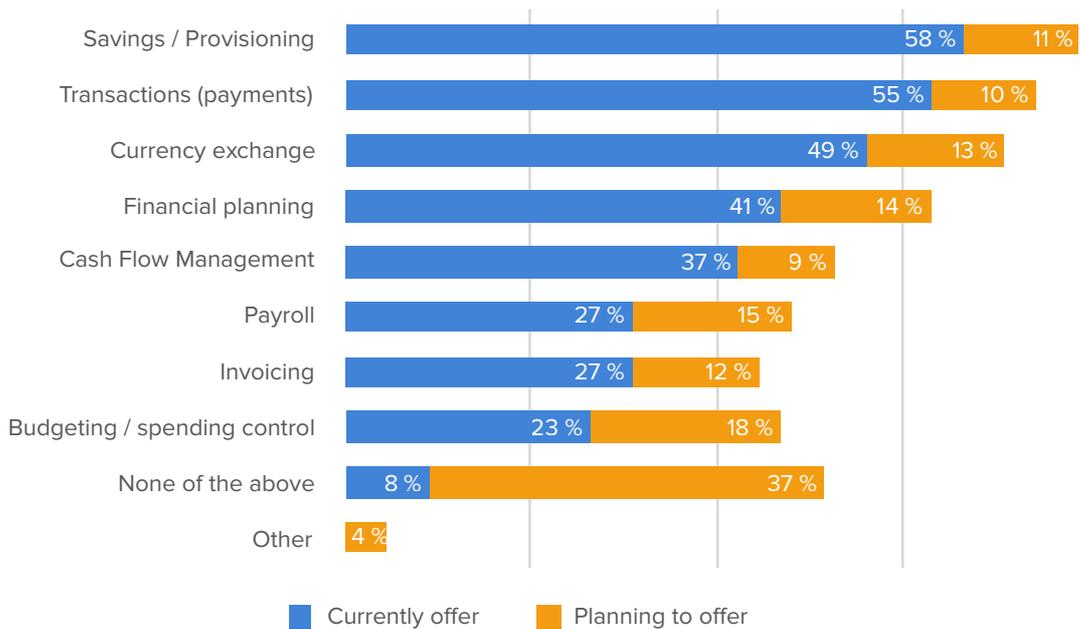
Conversely, micro businesses, with 1-10 employees, are less positive. 21% of these firms don't think banks provide good advice. These smaller businesses are unlikely to interact with their bank and share as much financial data, contributing to this loss of confidence. Banks need to pay special attention to this sub-segment's digital banking needs and address their specific requirements to build a stronger relationship.

### How well do you think your bank understands your financial and banking needs? (SMEs with 1-10 employees)



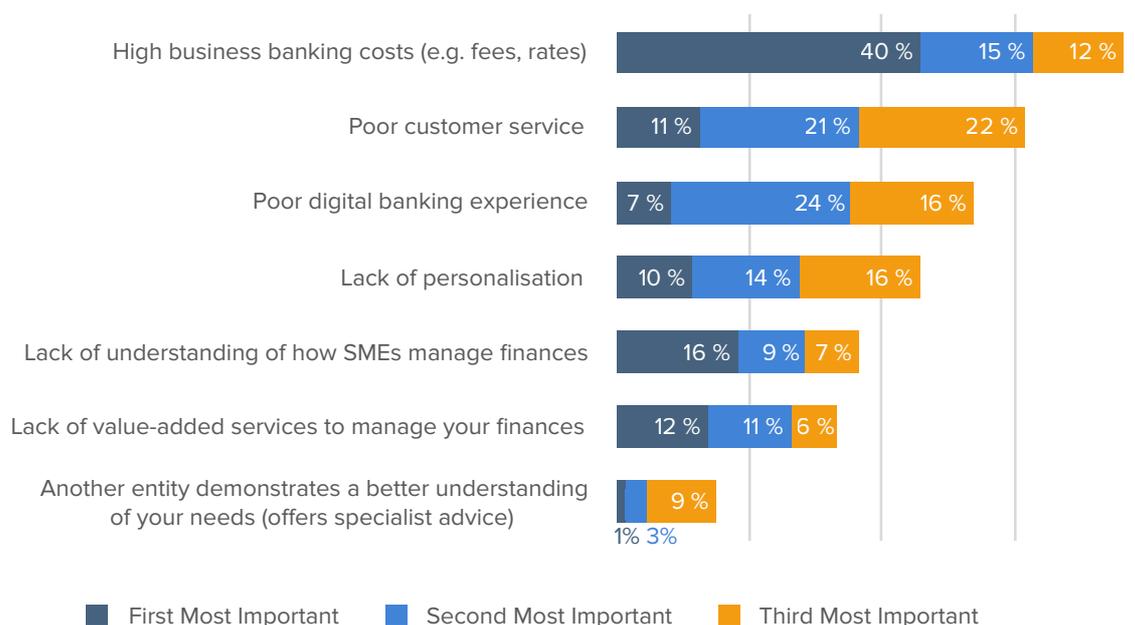
Overall, the problem is this intelligence being wrongly applied. Less than half of SMEs say they currently receive financial planning functionality from their bank and less than a quarter have access to budgeting/spending tools. Worryingly, the availability of these services isn't set to grow significantly in the next 12 months.

### Which of the following digital banking functionalities does your bank currently and plan to offer?



With 40% of SMEs listing “lack of personalisation” as a major reason to leave their current provider, banks need to not only provide financial planning services and tools, banks need to not only provide financial planning services and tools, but make them fully bespoke to the customer. There is enormous scope for banks to use existing data to offer personalised products and even third-party services with the emergence of Open Banking.

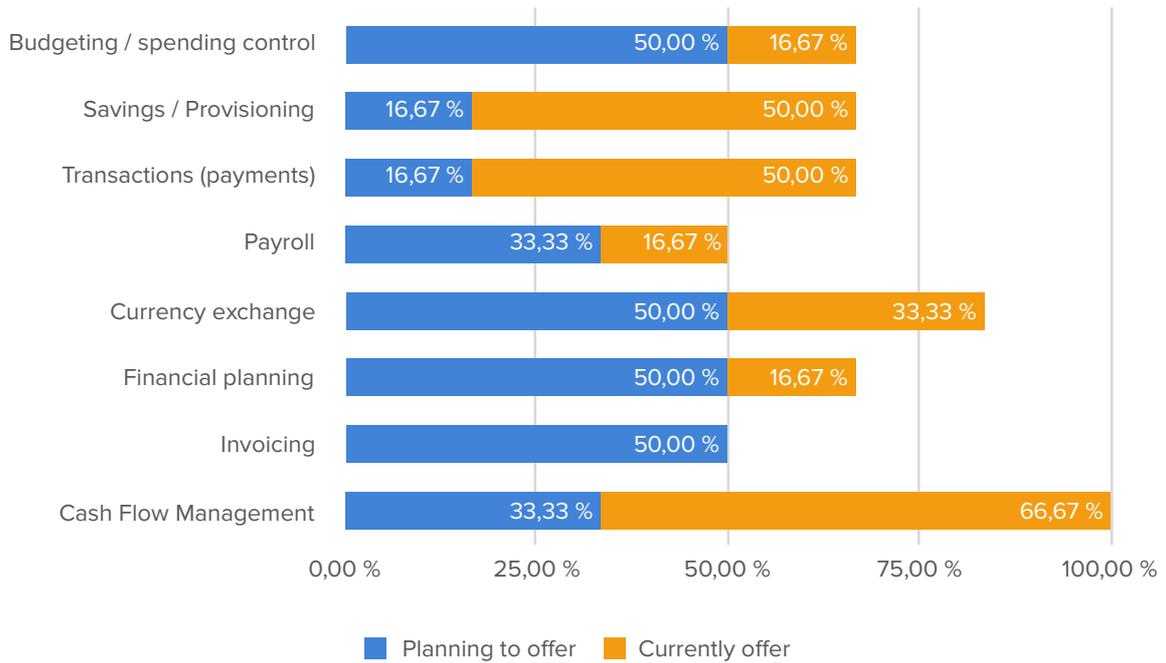
### What would make you leave your bank for a competitor?



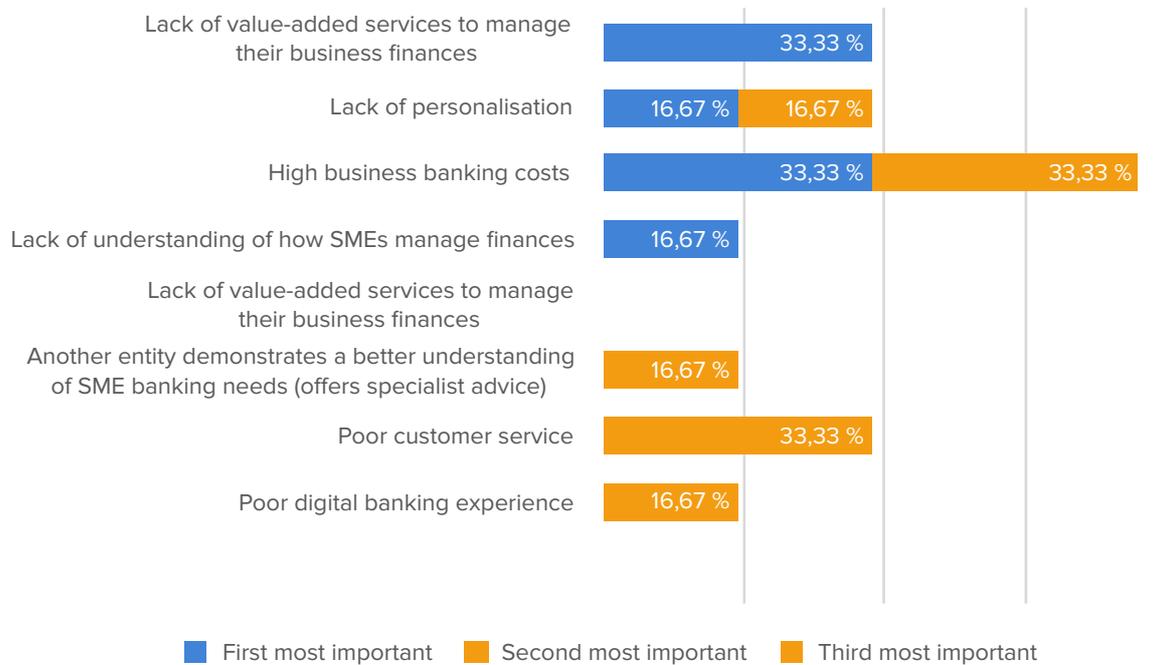
Banks do agree to an extent, with an understanding from all surveyed banks that personalisation is important, but only 17% think it’s reason enough to leave. In addition, what these personalised services are is not well understood. Only 17% of banks currently offer financial planning services and tools digitally, with 50% offering (or planning to offer) access to third party services.

The major issue is that they do not think that the lack of these services is a reason to leave. 33% feel that a lack of business planning tools is a contributor, and only 17% believe that a poor digital experience will cause SMEs to leave.

### Which of the following digital banking functionalities do you currently and plan to offer?



### Why do you think SMEs leave your bank for a competitor?



Fundamentally, banks seem more focused on increasing revenue per customer by selling traditional banking products rather than by providing business advice and guidance. They have the financial insight necessary to provide this but are not applying it, creating a major churn risk.

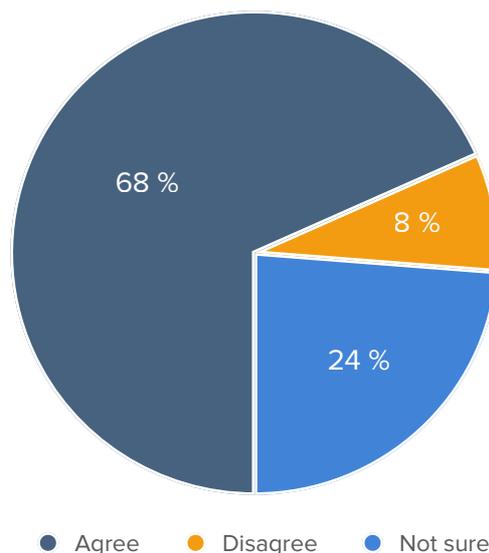
**Key findings:**

- A huge 91% of SMEs think their bank understands their financial needs well or fairly well
- However 21% of micro business don't think banks provide good advice
- A staggering 40% of SMEs see a lack of personalisation as a reason to leave
- Only 17% of banks think personalisation is a reason for SMEs to leave
- 17% of banks provide a digital financial planning service
- Just 17% of banks believe a poor digital experience is a reason to switch

## IV. Utility provider, not business partner

Currently SMEs do not value their relationship with their bank. Nearly 70% of SMEs regard their bank as a utility partner rather than a business partner and 83% of banks admit that this is the case. Only 8% of SMEs see their bank as a business partner. The reason for this perception is highlighted when we compare what SMEs want versus what they are offered.

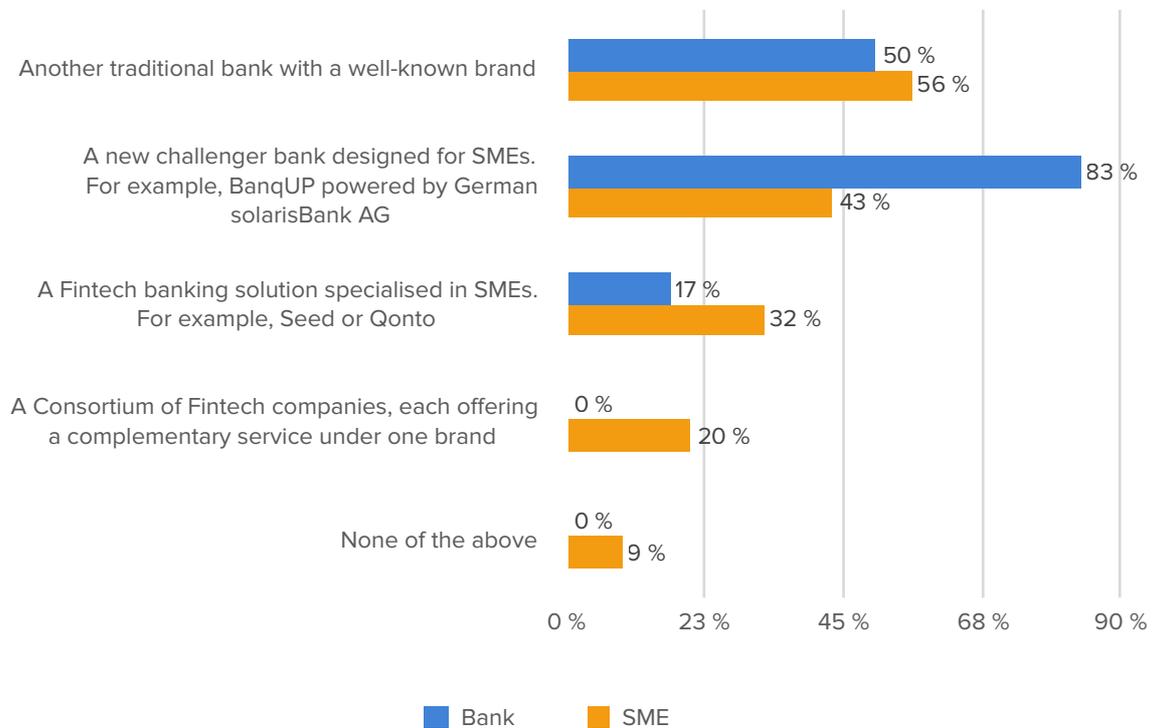
**Do you agree with this statement: “SMEs currently believe that banks are a utility provider rather than business partner?”**



Cash flow management, credit facilities and financial planning are the priority digital service needs for SMEs. Banks offer productised, transactional services to SMEs when they are crying out for guidance and advice.

With 43% and 32% of SMEs considering switching to a challenger bank or Fintech provider respectively, banks need to strengthen their relationship with SMEs or lose their grip on the market entirely. Banks are keenly aware of the threat posed with 83% saying that SMEs are likely to open an account with a challenger bank. Only 50% felt that traditional banks were likely competitors.

## Where else would you/your SME customers consider opening a bank account?



This clearly highlights the fact that the banks themselves are aware of increased competition and need to differentiate their offering. The vast majority of banks surveyed understood that SMEs would rather switch to a challenger bank than continue to have a relationship with a traditional one. After decades of competing with each other, banks have already concluded that challengers pose a grave threat but have been unable to change their businesses to respond to it.

When asked what was causing this paralysis, 50% of banks pointed to a lack of a sufficient budget. Overcoming legacy technology, regulation and managing organisational change were also given as reasons for a delay in implementing digital financial planning services by a third of banks.

## What are the key challenges for your bank to incorporate new bespoke digital banking services for SMEs?



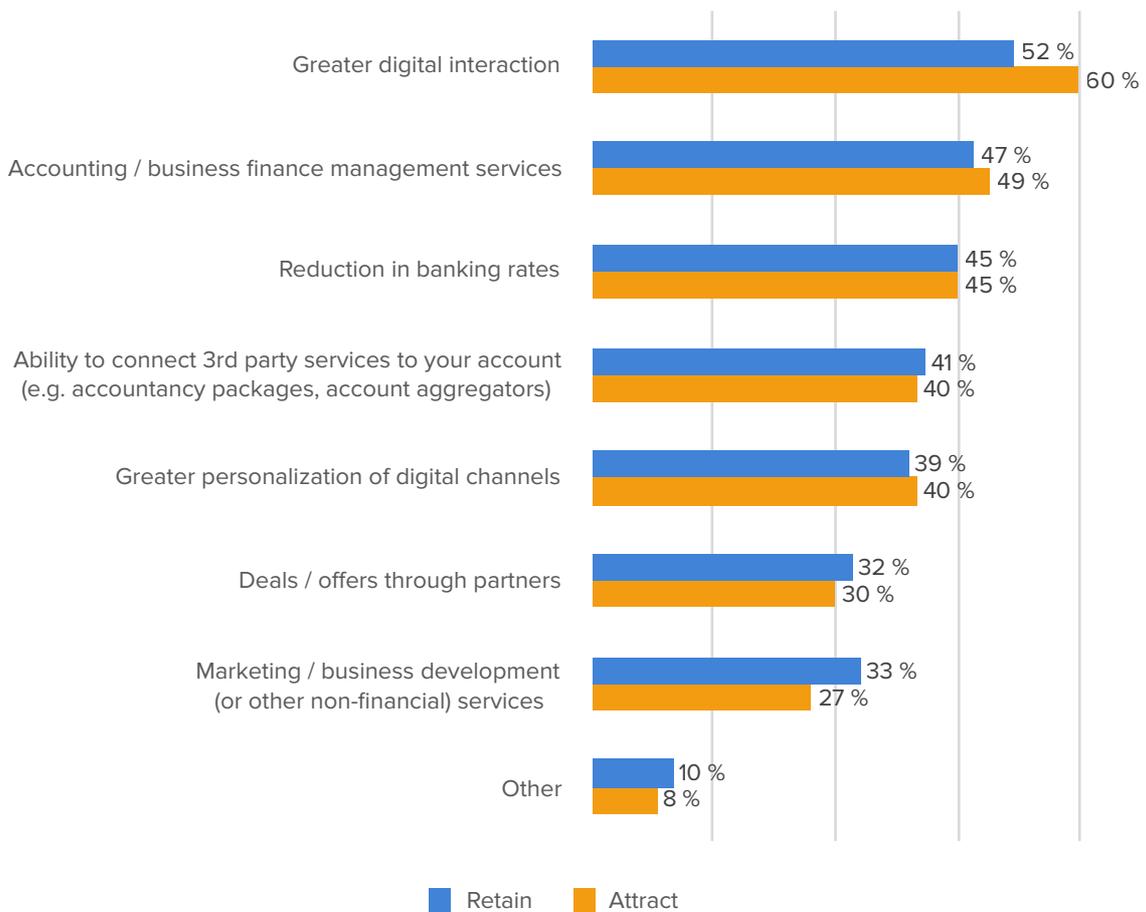
### Key findings:

- 69% of SMEs regard their bank as a utility provider, and banks are aware of this perception
- Only 8% of SMEs see their bank as a business partner
- 61% of SMEs place cash flow management in their top three priorities and all banks surveyed say that this is a service they are constantly asked for
- 43% of SMEs are considering switching to a challenger bank and banks see challengers as their primary competitor
- Half of banks feel unable to change due to a lack of available budget

## V. Digital engagement is #1 driver for SMEs

SMEs regard digital interaction as the most effective way to attract as well as retain their business. This is followed by financial management services, with nearly 50% of SMEs ranking it the second most important factor in attracting and retaining their business. All of the surveyed banks are focusing on digital to attract and retain customers, yet only 17% of banks offer digital financial management tools.

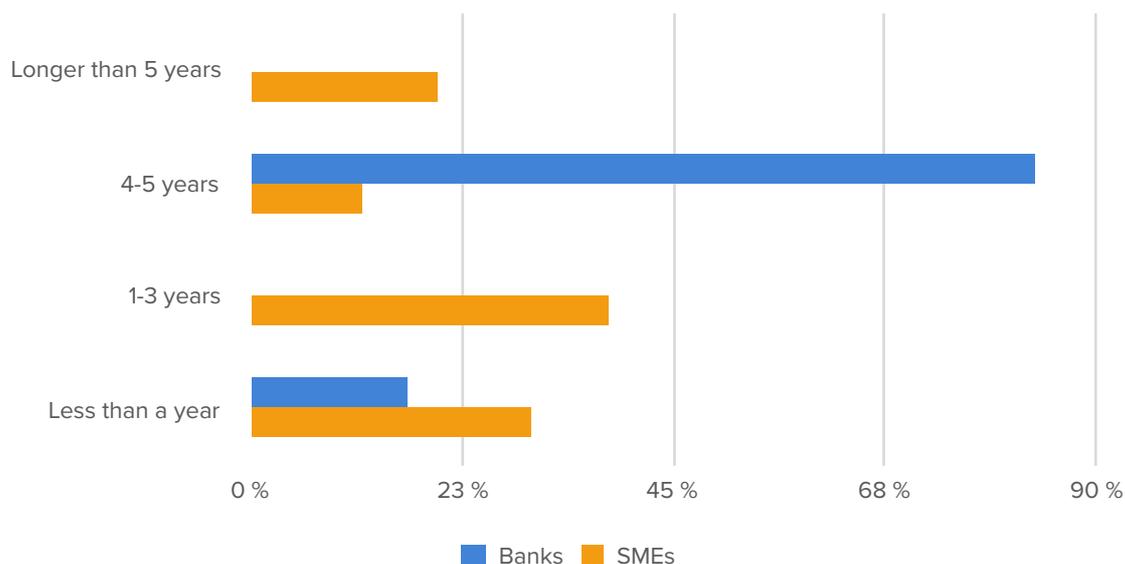
### Which of these is the most effective things your bank does to attract and retain your business?



Digital is no longer an option, but a must - something that banks already know but have not been able to realise fully. To date, basic, transactional services have been digitised but this hasn't extended to financial management. The result is the collapse of the personal relationship that banks once had with their SME customers, as evidenced by the fact that SMEs are missing the advice they traditionally received.

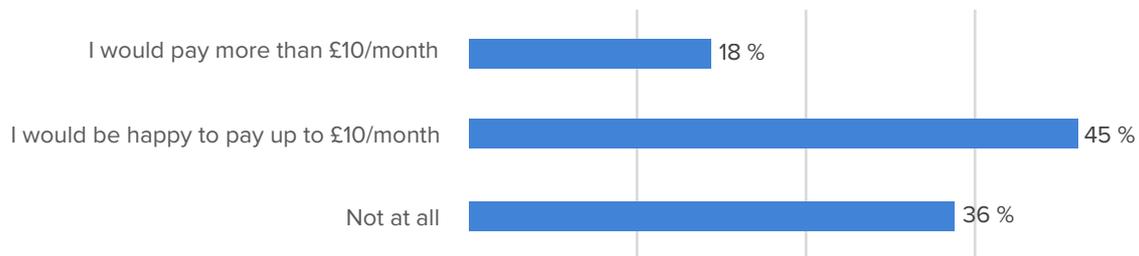
As they have made clear, digital is the delivery method of choice, as 68% of SMEs believe they'll no longer need to visit their branch in the next three years. However the pace of progress - if set by the banks - is not going to be as fast. 83% believe that it will take 4-5 years for banking to be conducted exclusively out of branch. This paints a picture of SMEs demanding change but the banks being unable to make those changes fast enough.

**When do you think you will you no longer need to visit the branch to access business banking?**



If banks are to retain, let alone attract, SMEs the message is clear: deliver financial management services, digitally, now. Additionally, SMEs are not only desperate for this service, 63% will pay with nearly one in five saying they would pay over £10, and given there are millions of SMEs across Europe, the potential revenues are considerable.

## If you value some form of digital money management solution, how willing would you be to pay for it?



### Key findings:

- Greater digital interaction is the most effective way to retain and attract SMEs and banks realise this
- Financial management is the second most effective way to retain and attract SMEs but this is missing from banks' offerings - only 17% currently offer this
- 63% of SMEs would pay for digital money management
- Nearly 20% of SMEs would pay more than £10 per month for such as service
- 68% of SMEs believe they'll no longer need to visit their bank branch in the next 1-2 years
- 83% of banks believe this transition to digital will take 4-5 years

## VI. Conclusion and recommendations

When it comes to banking, SMEs want to give their business to banks. Despite being swayed by challenger banks and Fintechs, more than half of SMEs would still choose a traditional bank with a well-known brand. Furthermore, three quarters of SMEs only bank with one or two providers. These businesses, the lifeblood of our economies, are by and large loyal to incumbent banks.

The drive to digital has meant that SMEs are lacking the financial planning and advice that they used to receive. They are seeking personalised financial advice, delivered digitally to help them manage and grow their businesses.

Incumbents are increasingly regarded as a utility; a provider of transactional services. The banks themselves do not believe SMEs will switch to another traditional provider, but rather migrate to challenger banks.

Traditional banks are trying to change; many of them understand the majority of concerns SMEs have and are trying to help, though digital transformation efforts have been misdirected so far. Banks have a small window to effect change before SMEs start to look elsewhere.

The situation is not insurmountable. Traditional banks have the relationships with SMEs and are still the providers of choice to SMEs. These banks have the financial intelligence SMEs crave. Banks simply need to apply this intelligence – digitally, and in a personalised way – to become business partners, and in doing so retain and grow their SME market share.

### **Key recommendations:**

- Uncover the potential of existing data to better understand SME financial situation and behavioural patterns.
- Integrate white-label data-driven technology with the existing banking systems, to accelerate the innovation process and deliver solutions SMEs are looking for, with a faster time to market.

- Leverage the potential of artificial intelligence and offer personalised advice and services.
- Accelerate the process towards Open Banking and offer relevant products and services both financial and from third party providers.
- Become your SME's everyday bank: create a close relationship with your clients by understanding well their needs, offering personalised advice, and enabling them to better manage their finances by using such tools as Business Financial Management.

## Methodology

The research was conducted through two individual surveys carried out firstly with SMEs, focused on understanding how SMEs viewed their bank and how well they thought their banks understood their needs. Over 200 UK companies employing up to 250 people were interviewed in August 2017 by Sapio Research on behalf of Strands. Every respondent was responsible for managing the relationship with the company's bank.

The second part of the research and data collection was conducted through interviews with banks serving over 1.3m UK SMEs. Executives responsible for SME banking were interviewed between August and September 2017 and were given the same questions as the SMEs.



# STRANDS BFM: POWERING INNOVATION

Through harnessing our capabilities in machine learning, big data and customer behavior analytics, we have developed the **Strands BFM**, designed to offer your bank's SME clients an intuitive, value-added product that implements seamlessly into their online banking portal. Some features include:

## INVOICING MADE EASY

for the SME and your bank with effortless end-to-end payment cycles

## FINANCIAL CALENDAR

with heat mapping that indicates daily, weekly, monthly and yearly spending patterns

## INCOME AND EXPENSES ANALYSIS

through a frictionless, intuitive user interface

## BUDGETING

to keep a lid on expenses

## CASH FLOW ANALYSIS

with historical, current and predicted inflows and outflows

## PROVISIONING

to aid SME clients in reaching their business goals

With the Strands BFM, your bank will be primed to tap into this new multi-billion dollar SME banking ecosystem, helping SMEs to better manage their business and grow in a sustainable manner.

[finance.strands.com/resources](http://finance.strands.com/resources)





## STRANDS WORLDWIDE

Strands is the FinTech partner for banks, having delivered more than 600 bank implementations for over 100 million customers in 36 countries to date. Clients include HSBC, BBVA, Novobanco, Commercial Bank of Africa, Bank of Georgia, Akbank, and Huntington, among others.

The company's mission is to enable banks and merchants to anticipate customer needs and proactively suggest next-best-actions to increase long-term customer value. Strands' solutions empower people to better manage their financial and consumer lifestyle, and make decisions in a smarter, more transparent and independent way.

From our offices Barcelona, Buenos Aires, Kuala Lumpur, Mexico City and Miami, we serve banks worldwide including Abu Dhabi Commercial Bank, Allied Irish Banks, BAC Credomatic, BBVA, Israel Discount Bank and Davivienda, among others.



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