Banking for Small and Medium Enterprises – Towards a Digital Future

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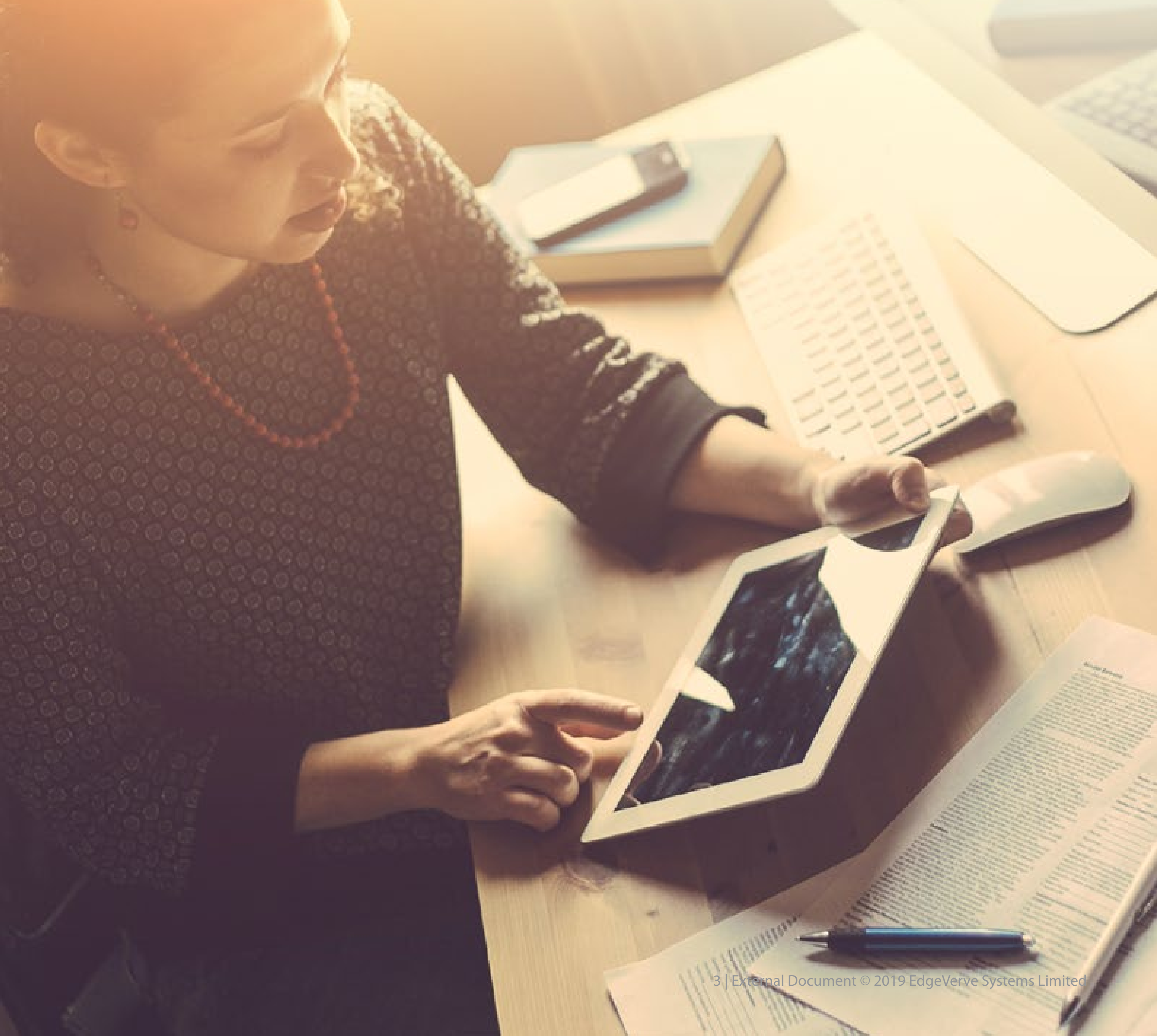
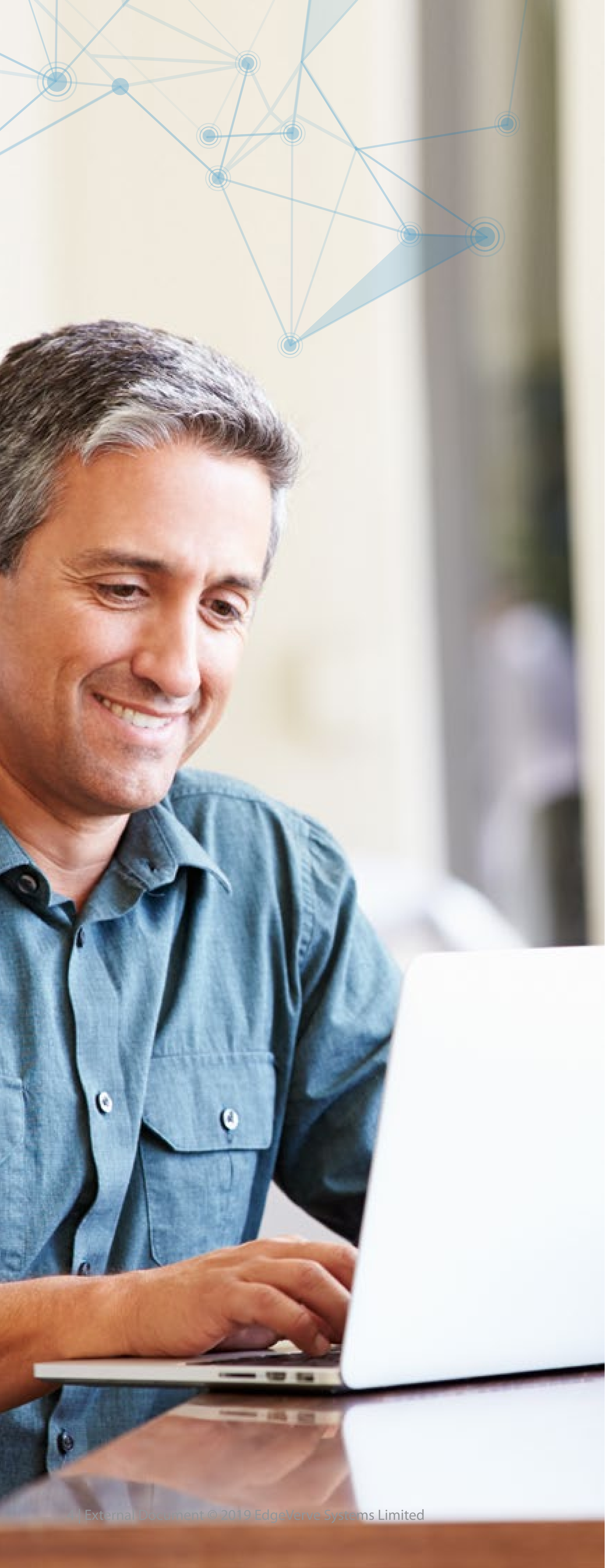
Introduction

Small and medium-size enterprises – independent firms that employ far fewer employees than large corporates – not only have a relatively limited human capital but also a different set of challenges and business needs. These businesses across the globe are largely underserved as compared to their corporate or retail peers when it comes to banking.

This point-of-view, put together by the Banking Visionaries' Council aims to provide an overview and an underview of the banking needs of this segment, along with recommendations for banks to innovatively serve the segment with digital solutions.

The Banking Visionaries' Council, an industry thought leadership initiative brings together leaders and practitioners from eleven countries and six continents to discuss and create research-led actionable point-of-view assets about the most pressing challenges and trends facing the industry.





Five Common Constraints of SMEs

Small and medium businesses across the world differ in the way they operate, the environment they operate in, and the business sector they belong to. So do their challenges and their banking needs. However, there are also a set of challenges common to SMEs worldwide.

Some of the common challenges SMEs face include:

1. Financial constraints

Credit gap and financial constraints are the most significant challenges before SMEs. Findings of a research by IFC indicate that about 80 percent of SMEs are financially constrained in Europe and Central Asia. In Eastern Europe, the SME credit gap remains one of the most significant limitations to growth. According to a recent survey of SMEs in South East Asia, nearly 68% of SMEs were reported to face lack of funding support from banks and were open to non-traditional lending.

This is largely because banks are keen on serving the more attractive large corporate and retail customer base often neglecting the complex and less lucrative SME segment. Lenders, especially traditional banks, continue to consider small businesses a high-risk segment. Accessibility to funds is a challenge also due to failure on the part of SMEs to meet a financial institution's lending requirements. Since SMEs do not mandatorily undergo financial audits, many times they fail to provide the required documentation for a successful loan application. Furthermore, the lending process at banks is typically fairly time-consuming.

Thus there is a growing premium on non-traditional avenues and sources of lending. SMEs have found the answer in alternative peer-to-peer marketplace lenders. Research findings reveal that about 50 to 80 percent SMEs today actively seek loans from non-traditional lenders that have risen to fill the void in the underserved SME lending space. Millennial SME owners are nearly twice as likely as older owners to use alternative lenders in the U.S.A. In countries such as Australia, the number of SMEs that consider non-bank funding as the most preferred option has increased to 22% from 11% just three years ago.

2. Lack of integrated packages for SMEs

SMEs, especially small businesses amass little expertise beyond their core competency, and rarely have the resources for extensive specialized supporting functions of a business such as Legal, HR, and Finance. What they require is a lock stock solution from their banks that can be integrated with their systems and can help simplify operations of these auxiliary units that consist of just a couple of FTEs or less.

Additionally, banks should make these solutions modular so they can be easily customized for different industry verticals since there's a world of difference between how SMEs in different industries operate.

3. Complex end-to-end processes

Standard processes at banks in some cases require months for complete documentation, processing and provisioning to take place. Small businesses do not have the luxury of time for such lengthy processes. Given the nature of these businesses, the lead time and windows are significantly shorter for SMEs who look to have their requirements serviced within a couple of weeks or days. Complex and time-consuming processes only drive SMEs away towards agile alternative providers. Banks need to make the end-to-end process for all their services to SMEs exceptionally simple and quick.

4. Lack of digital enablement capabilities

The industry has adequately responded to the shift to digital channels in retail banking, as is evident in the progressive increase in channel investment globally. As compared to large corporates, SMEs are much more agile in the way they operate. However, the rigor and focus on digital channels doesn't quite level up when it comes to SME banking. SMEs prefer performing transactions on digital channels for nearly all their requirements across payments, deposits, credit financing, cash management, risk management, and tax and regulatory assistance. A PWC survey reports a stark gap between the percentage of SMEs who prefer online / mobile channels for requirements spanning all these areas and the percentage of transactions currently performed on these channels. For instance, about 80% SMEs globally prefer online / mobile channels to transfer money or make payments, but only about 66% of SMEs can use these channels successfully for payments. Similarly, about 64% SMEs were reported to prefer these channels for their financial or cash management needs, versus only about 52% who are currently satisfied using them. This indicates considerable room to shift users of channels such as call centers and good old face-to-face interactions over to digital channels.

5. Limited capabilities for integration with ecosystem participants

Ecosystem-driven banking is fast becoming the new normal. But SMEs took to the concept way before it made headway in the industry. This is partly due to the propensity of SMEs to outsource or partner with experts in areas outside of their domain expertise. For instance, a majority of SMEs are capable of running their solutions on cloud. Thus innovative and affordable cloud-based account management software solutions have begun witnessing a surge in demand. An ecosystem of financial service providers such as FinTechs, and non-financial providers such as Xero, and other digital service providers is what SMEs have wanted for a long time. However, most SME solutions do not allow SMEs to seamlessly work and integrate with different participants of an ecosystem.

Five ways banks can serve their SME customers digitally

Banks have long missed out on serving the SME banking audience effectively, in lieu of the more lucrative retail and corporate banking customers. But now SMEs are swiftly taking to alternative lenders and other emerging market players, and banks stand to lose business in this segment if they continue to overlook it.

Digital tools and technologies have made it significantly easier for banks to make life easy for their SME customers. Here we present 5 such opportunities for banks to boost access to capital, productivity, and banking experience for their SME customers.

SMEs are investing more in digital

Digitization in SME banking may not have picked up at the same pace as in segments such as retail or large corporates, but the good news is that SMEs are acutely aware of the gaps and are more than willing to invest more in digital and technology solutions to bridge these gaps. Technology's share of SME investment dollars has ballooned in the past couple of years. According to a research report by Ernst & Young, United Overseas Bank, and Dun & Bradstreet, about 60% of SMEs in ASEAN are keen on investing in technology, as opposed to 45% in fixed assets such as plant, machinery and equipment and 35% in current assets. Furthermore, among technology areas, software and services such as developing mobile apps., enhancing the website, ramping up digital marketing efforts and IT improvements constitute the highest share of investment (78%). About 46% were reported to be interested in pay-per-use and software-as-a-service for business processes such as accounting, invoicing and payroll to enhance business performance.

In advanced markets, research shows that new ways of managing payments and invoicing, increased automation, and cloud and advisory services constitute the top areas of investment.

The inclination towards investment in tech and digital dispels any doubt about the readiness of SMEs for new technology. SMEs are seemingly more than ready to welcome any solutions from their bank that make adoption of these technologies easier, help them automate more functions, aid collaboration, and empower them with insights through functions inbuilt in banking solutions.

Five opportunities for banks

1. Marketplace lending

One of the key differences between traditional lending and marketplace lending is that the former depends on the scale of a single traditional lender for deposit and lending services. A traditional lender such as a bank provides interest in return for savings and deposits, and uses these deposits to offer loans to borrowers seeking funds, after evaluating eligibility based on creditworthiness. So the higher the transactions, the higher the success of lending business. Marketplace lending, on the other hand, puts borrowers and lenders in direct touch with each other, and both the parties have the liberty to choose their risk portfolio. With the increasing popularity of marketplace and peer-to-peer lending given the transparency of risk portfolios, quick loan disbursement, and relatively low charges, banks can utilize this channel to reach more customers and prospects. They can do this in three key ways. Let us explore these with a hypothetical example of an SME looking to secure funds for business.

Partnering with marketplace lenders

A bank can choose to partner with one or multiple marketplace lenders and act as a resale agency for these alternative financing firms.

Example: An SME seeks a loan worth $500,000 from a traditional bank. However, the SME is unable to comply with and fulfill a bank's minimum requirement for a $500,000 loan. The bank can thus serve the SME by offering a third-party marketplace lending product instead of its own. This way, the bank earns fee revenue from the third-party marketplace lender and is able to retain and manage its relationship with the customer effectively.

Hybrid product integration

A bank can design a hybrid lending product by providing part of the funding and commissioning the remaining through a third-party marketplace lender.

Example: An SME seeks a loan worth $500,000, and approaches a bank. But the bank has stringent restrictions and cap on credit. It pegs this SME's eligibility at $300,000. The bank fulfills 60% of the loan requirement ($300,000), and for the remaining funds directs the SME to a lending marketplace partner. Thus the SME secures the requisite loan, and the bank prevents losing a customer to another financial institution.

Credit integration

A bank can utilize the social/digital credit evaluation from a third party marketplace vendor.

Example: An SME seeks a loan worth 500,000, and approaches the bank. But the SME is not able to meet the minimum lending requirement for a $500,000 loan if the bank evaluates the customer using its stand-alone analytics and credit score calculation mechanism. The bank can service the credit limit of $400,000. The bank, however, has a data sharing agreement or partnership with Alibaba. The SME's historical records with the e-commerce giant reveal no default and the analytics engine suggests that another $100,000 credit could potentially be added to the original limit. In this case, the bank analyzes not just the bank's data but also integrates its evaluation model with the third party provider's credit mechanism to eventually service the full loan requirement of $500,000. Thus it's a win-win for the customer as well as the bank. And Alibaba benefits from partnership with banks and financial institutions for data.

Marketplace lending

2. Integrated software suites

SMEs typically use a variety of systems for managing different functions such as payroll management, sales, purchasing and procurement, CRM, ERP, and collaboration tools for networking with participants in the supply chain and other SMEs. There is a high correlation between the data generated during various processes spanning these functions. Time-strapped SMEs are forever looking for efficient solutions to simplify their operations with an integrated view of all their data to drive actionable insights and decisions. Solutions from banks that can be integrated with SME systems can not only help SMEs make more informed decisions, but can also help improve access to financing. For instance, insights from sales and purchasing can be leveraged for receivables management and in turn for receivables financing. Since SMEs do not have a great many physical assets that can be collateralized, banks can explore transaction data such as purchasing and procurement, and in some cases even information about the intellectual property as fresh insight to support SMEs' credit financing needs.

3. Cloud to simplify processes

Cloud has been crucial in equipping SMEs with affordable computing power, and over the years SMEs have come to adopt cloud as a way of life hosting more and more applications on cloud. So it's important for banks that their solutions are capable of integrating with SME applications on the cloud for effective utilization of data. But more than this, banks have been the trusted custodian of funds for eons and can augment their solutions with enhanced features to provide more value by simplifying some banking processes for SMEs. For instance, banks can integrate cloud services such as digital lockbox into their solution suite allowing SMEs to upload their digital credentials, files and physical receipts to their bank's cloud. This is one way to make banking smarter for SMEs with paperless and faster processes.

4. Enhanced SME digital enablement

As stated before, SMEs use a variety of tools, systems, and partners for enhanced efficiencies, synergies and business growth. These also include solutions from FinTechs at offer digital enablement capabilities for account reconciliation, video conferencing, cloud services, chatbot customer services, biometric authentications and several others. Banks should partner with such specialists or integrate their solutions with capabilities from these providers to form an ecosystem for advantages of data and enhanced business collaboration.

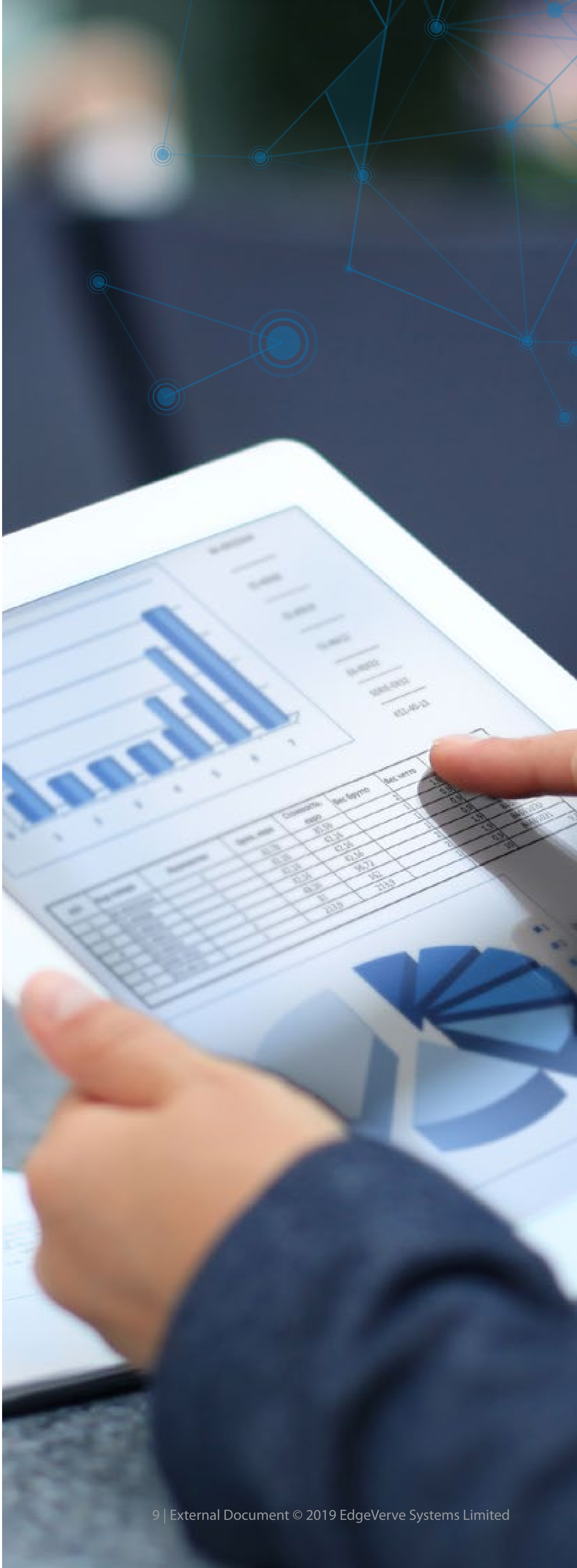
5. Business Finance Management (BFM)

Banks have been helping their retail customers manage their money with personal financial management (PFM) solutions for a long time. PFM software now enables banks to deliver these services digitally and efficiently.

Some FinTechs have begun extending personal finance management (PFM) services to offer business finance management (BFM) services to SMEs. This allows businesses to slice and dice information as required to gain an understanding of their income & expenses, transactions, invoicing, budgeting, provisioning, financial calendar, etc. with the help of reader-friendly dashboards. For example, MasterCard and Strands Business Financial Management have joined hands for an AI solution enabling SMEs to forecast cash flow, analyze finances and benefit from recommendations for services from their banks. Banks can also create solutions such as these to serve SMEs better, and potentially increase their revenue from the segment.

Conclusion

A small business's needs differ from those of a medium enterprise and are starkly different from what a large international corporation expects from its bank. Traditional corporate banking products cannot successfully serve this segment. But unfortunately, banks have always considered small businesses a high-risk segment as a result of which SMEs have been devoid of their fair share of custom financial solutions for far too long. But digitization presents banks with opportunities aplenty to serve the segment with new innovative solutions. Ecosystems and partnerships with new agile financial and non-financial players form the core of new emerging models that banks must pursue. With new digital tools and emerging technologies, banks can also work to expand SMEs' access to finance significantly.



About Banking Visionaries' Council (BVC)

Banking Visionaries' Council has been instituted by Infosys Finacle to collaborate with senior business and technology leaders from the banking community to develop actionable point-of-views around contemporary themes within the industry. The purpose of this council is to solve the most pertinent problems with research and collective thought leadership efforts. Currently, the council consists of a twenty-member-strong board with representation from eleven countries across six continents.

This point of view paper is an abridged version of the collaborative research work done by the council.

For more information on the council, please reach out to finacle@edgeverve.com

Share key market development and trends observed in respective geos with rest of the group

Collaborate to develop actionable point-of-view on how banks can leverage emerging trends

Openly discuss learning from innovation initiatives taken by respective banks

About Infosys Finacle

Finacle is the industry-leading digital banking solution suite from EdgeVerve Systems, a wholly owned product subsidiary of Infosys. Finacle helps traditional and emerging financial institutions drive truly digital transformation to achieve frictionless customer experiences, larger ecosystem play, insights–driven interactions and ubiquitous automation. Today, banks in over 100 countries rely on Finacle to service more than a billion consumers and 1.3 billion accounts.

Finacle solutions address the core banking, omnichannel banking, payments, treasury, origination, liquidity management, Islamic banking, wealth management, analytics, artificial intelligence, and blockchain requirements of financial institutions to drive business excellence. An assessment of the top 1250 banks in the world reveals that institutions powered by the Finacle Core Banking solution, on average, enjoy 7.2% points lower costs-to-income ratio than others.

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