

OPEN

7 Factors

Powering the SME
Banking Paradigm Shift

7 Factors

Powering the SME Banking Paradigm Shift

“Banks have a once in a generation opportunity to redefine their relationship with SMEs. This will allow them to energize their entire business model towards innovation, customer loyalty and increased revenues. The smart bank will empower SMEs with added-value online services and become their trusted finance management partner. This is the new era in SME banking”

Oscar Sala

VP Product Strategy



© Strands

All rights reserved. No part of this publication text may be uploaded or posted online without the prior permission of the publisher.

For permission requests, write to the publisher, addressed "Attention: Permissions Request," to marketing@strands.com

EDITOR'S NOTE

A new period in SME banking has already begun and a whole new ecosystem for how banks serve small to medium-sized enterprises is set to prosper. This new era will be driven by the SME needs of managing their business to sharpen competitiveness in today's digital world.

There is a growing opportunity for banks to become SME's digital disruption partner. No entity is better placed to do so: banks have a (long-term) relationship and have built trust with business owners; they have data about their current and future financial needs; and they have access to the expertise and technology. New solutions that enable to leverage customer insights will allow for the provision of value-added products, covering a

multitude of business needs, such as accounting and cash flow management.

While competition will be fierce, banks that can execute an effective SME strategy will reap the rewards. And those that don't take action will fall behind.

Let's look at the 7 factors for this paradigm shift in SME banking and the lucrative opportunities for banks:

- 1 IT'S CHEAPER AND EASIER THAN EVER BEFORE TO START AN SME
- 2 MILLENNIALS, THE NEW DOMINANT ECONOMIC COHORT, ARE EAGER TO START BUSINESSES
- 3 IT WILL HELP TO "BANK THE UNBANKED" AND BETTER SERVE THE UNDERBANKED
- 4 THE WORLD BANK AND G20 SHARE A COMMON GOAL TO HELP SMEs WORLDWIDE
- 5 SME DEMANDS AND NEEDS ARE CHANGING
- 6 THE FINTECH PHENOMENON AND BANKING DISRUPTION HAVE FORCED BANKS TO DEVELOP SUPERIOR FINANCIAL SERVICES
- 7 THERE IS MORE COMPETITION IN THE FINANCIAL SECTOR THAN EVER BEFORE

1

IT'S CHEAPER AND EASIER THAN EVER BEFORE TO START AN SME

Starting up obviously depends on the type of business, but it is by and large much cheaper than it has ever been. The average cost in the UK is just **£312**, for instance. While many of these new businesses are and will remain micro businesses, many will turn into more prominent SMEs, with higher revenues and staffing needs.

This reduction in cost is mainly thanks to advances in technology and the internet, as well as the removal of international trade barriers and faster, more secure international financial transactions, among other factors.

Talent can be located in a different city or country – even a different continent – at competitive pricing via any of a number of

freelancer websites (the so-called gig economy).

Communication costs have been completely eliminated thanks to free video, messaging and call services.

An online business means that renting premises is no longer a necessity for so many SMEs.

The UK has recently broken records for the number of new businesses registered, climbing to **600,000** in 2015 alone.

As it is so much cheaper to start a new company, the need for value-added business management products will rise, which offers a clear opportunity to banks ■

NEW BUSINESS CREATION BY COUNTRY

| Rank | Country | New businesses / Year | Rank | Country | New businesses / Year |
|------|----------------------|-----------------------|------|-------------|-----------------------|
| 01 | United Kingdom | 537,659 | 11 | Korea | 84,676 |
| 02 | Russia | 427,388 | 12 | Mexico | 76,447 |
| 03 | Australia | 231,920 | 13 | Brazil | 73,614 |
| 04 | South Africa | 217,624 | 14 | Nigeria | 71,941 |
| 05 | Hong Kong SAR, China | 167,280 | 15 | Germany | 68,526 |
| 06 | Chile | 98,405 | 16 | Colombia | 62,993 |
| 07 | India | 98,029 | 17 | Netherlands | 58,900 |
| 08 | France | 94,927 | 18 | Turkey | 57,760 |
| 09 | Italy | 91,853 | 19 | Romania | 56,381 |
| 10 | Spain | 91,544 | 20 | Malaysia | 49,203 |

Source: *Index Mundi*



MILLENNIALS, THE NEW DOMINANT ECONOMIC COHORT, ARE EAGER TO START BUSINESSES

Millennials – the generation born between 1982 and 2004 – could be “the most entrepreneurial generation ever,” according to [American Express](#).

[They have become the largest cohort in the United States](#) at over 75 million people, and in the 28-member European Union they represent [24% of the total population](#), which equates to some 121 million people.

Banks have learned that millennials have different consumer habits than previous generations. They grew up with technology and are the savviest tech generation in history. Moreover, they have expressed a solid interest in starting their own company.

This has necessitated a reinvention of the banking-customer relationship. The opportunity cost of failing to do so is enormous, evidenced in the numerous studies

carried out on how millennials view banks. These studies include the following takeaways:

71%

of millennials prefer to go to the dentist than listen to what banks say

53%

think that there is no differentiation whatsoever between what their bank offers from other banks

33%

think they will no longer need a bank in the future

Source: [BBVA](#)

The urgency and importance to banks cannot be understated, as these millennials will lead the SMEs of tomorrow. The above statistics, coupled with the millennial embracing of entrepreneurship indicates that a clear opportunity for banks is forming.



MILLENNIAL ENTREPRENEURSHIP: THE NUMBERS THAT MATTER

27

The average age of millennial startup founders compared to 35 for a baby boomer

66

Percentage of millennials who want to start their own business

75

Percentage of the global workforce which could be made up by millennials by 2025

7.7

The number of companies started on average by millennial entrepreneurs compared to between 3 and 4 for baby boomers

Sources: [BNP Paribas](#) and [Bentley University](#)

While the percentage of millennials as total SME owners is low – only 3.6% of all [businesses](#) in the United States in 2013 were started by millennials – banks can expect this to increase.

Let's not forget that the Global Financial Crisis hit this generation hard. It led to mass youth unemployment across the world, and so it is natural that they are biding their time. In fact, entrepreneurship has been one of the reactions to the crisis, as millennials have sought more innovative ways to advance their careers.

“Banks are best placed to provide SMEs with the value-added products they want and support them in adapting to the changing digital business landscape, thanks to their extensive client base”

They are used to technology at their fingertips. They are digitally savvy and more adaptable than previous generations. They will be eager for technology-driven business financial solutions, which should make banks sit up and take notice ■

IT WILL HELP TO “BANK THE UNBANKED” AND BETTER SERVE THE UNDERBANKED

There is a massive portion of SMEs that fall under both the unbanked and underbanked categories.

While significant progress has been made to better serve the smallest and largest of enterprises, it's the SMEs in between that go underserved. They have been dubbed “the missing middle.” These companies are typically credit-starved and do not have access to value-added products. This missing middle problem is particularly acute in [developing economies](#) (see graph The missing middle).

There is a \$2.38 trillion SME funding gap worldwide. Whereas in countries like Sweden, 80% of all SME funding comes from the banking sector, in [Africa 40% of SMEs are completely unbanked](#).

“Banking the unbanked” is a key challenge facing governments and the banking sector.

Between 2011 and 2014, the number of adults across the globe without a bank account dropped by 20%. There are however still [2 billion](#) adults who go bankless.

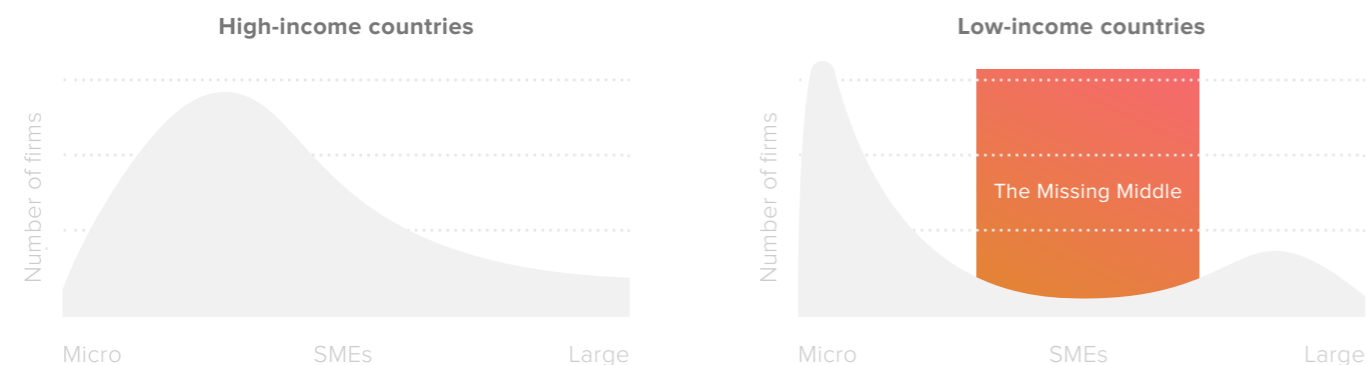
While developing countries contribute most to this figure, it's also a prevalent problem in developed countries. In the United States, for instance, there are [106 million](#) people in the unbanked/underbanked category, meaning that they either don't have any form of bank account or have poor access to financial services, and that they typically rely on non-bank financial transactions.

How can banks encourage people who fall into the unbanked/underbanked category to open up accounts and become customers?

If there are value-added products that make the process of personal banking easier, the unbanked/underbanked are more likely to respond positively, open an account and manage their finances through their new bank. The convenience of opening a bank account and managing your finances all from your cell phone is much more appealing than the prospect of repeatedly calling into a bank branch, after all.

Offering people easy-to-implement banking solutions will go a long way to building on the great work in recent years of banking the unbanked and serving the underbanked better ■

THE MISSING MIDDLE: THE FIRM SIZE DISTRIBUTION



Source: Center of International Development, Harvard University



THE WORLD BANK AND G20 SHARE A COMMON GOAL TO HELP SMES WORLDWIDE

SMEs make up most of a country's workforce and generally contribute the most to GDP collectively. Globally, they [create two-thirds of jobs, account for 50% of GDP and form 90% of all companies worldwide](#).

Managed by World Bank Group's International Finance Corporation, the SME Finance Forum was set up by the G20 Global Partnership for Financial Inclusion in 2012.

This group was set up to improve SME access to financial services. It is vocal regarding financial

innovation and the changes currently revamping the finance sector. Crucially, it encourages banks by highlighting the importance of SMEs in society and how they stand to benefit from offering them better products to help their business ■

5

SME DEMANDS AND NEEDS ARE CHANGING

The conversation about SME banking has for so long been dominated by a lack of banking finance. But this is set to change. Thanks to solutions that technology offers banks, opportunity has suddenly bloomed.

The SME stands to gain by using high quality digital financial and business services at low cost. The bank stands to gain through the potential to tap into a whole new set of business opportunities for SMEs, creating a new win-win SME banking model.

If a bank chooses to forego this opportunity, they risk losing their SME clients to other banks or fintechs. In fact, **68%** of SMEs are now prepared to leave their bank for better business and financial services. To further highlight this risk, it is now easier than ever to switch an account over to another bank or to use a fintech provider for specific financial needs such as foreign exchange.

“The bottom line is that now SMEs have options, and if banks don’t provide them with value-added products, they will find an alternative provider who will.”

As the business landscape evolves, with developments and challenges in digital technology, globalization and financing, SMEs need to adapt. And they want help to take on these challenges, including the following:

High quality, high value digital products (with potential revenue-share options)

SMEs need help to run their businesses, often in areas where they are not specialized or count on a specialist employee. Such areas include accounting, payments, cash flow management and balance sheet management.

Accessible, sustainable pricing

Cash flow is usually an issue for SMEs. They want these products at prices they can afford. They are willing to pay for them, as they know it saves time (and headaches) and it helps them to run their business better, and more profitably.

Convenience

Multi-user, digital access and speed across all types of device are essential for SMEs.

Ease of use

The SME products should be straightforward to use and free of any requirement of specialist knowledge.

A personal touch

SMEs want tailored advice, delivered efficiently across various channels if need be, by people with whom they can build a working relationship.

International expansion and sustainable growth

The smart bank will help SME client development through offering high-value products but also, importantly, by sharing risk as well as the spoils of success. This point is particularly eye-catching for banks, as it represents a clear path to revenue growth and higher degree of loyalty, especially as businesses become more solid and international organizations.

WHAT DO SMEs REALLY WANT?

The need for SMEs to become financially literate is also evident. Many SME owners are simply not knowledgeable when it comes to finance and in addressing this problem, it would open up greater possibilities for their company. Fortunately, it is easier than ever before to become financially literate.

Before, attending a course in person, which was usually expensive and time-consuming, would have been the solution. Now, there are online courses at accessible prices (or free), as well as online resources and scores of books on business finance that have come out in recent years.

Most SMEs do not have a financial director or a business analyst. They don't typically have the expert knowledge on foreign exchange, payments or on making their supply chain more efficient, among other areas.

Banks can provide what SMEs crave – a business partner one-stop-shop for their financial and business needs at an accessible price ■



6

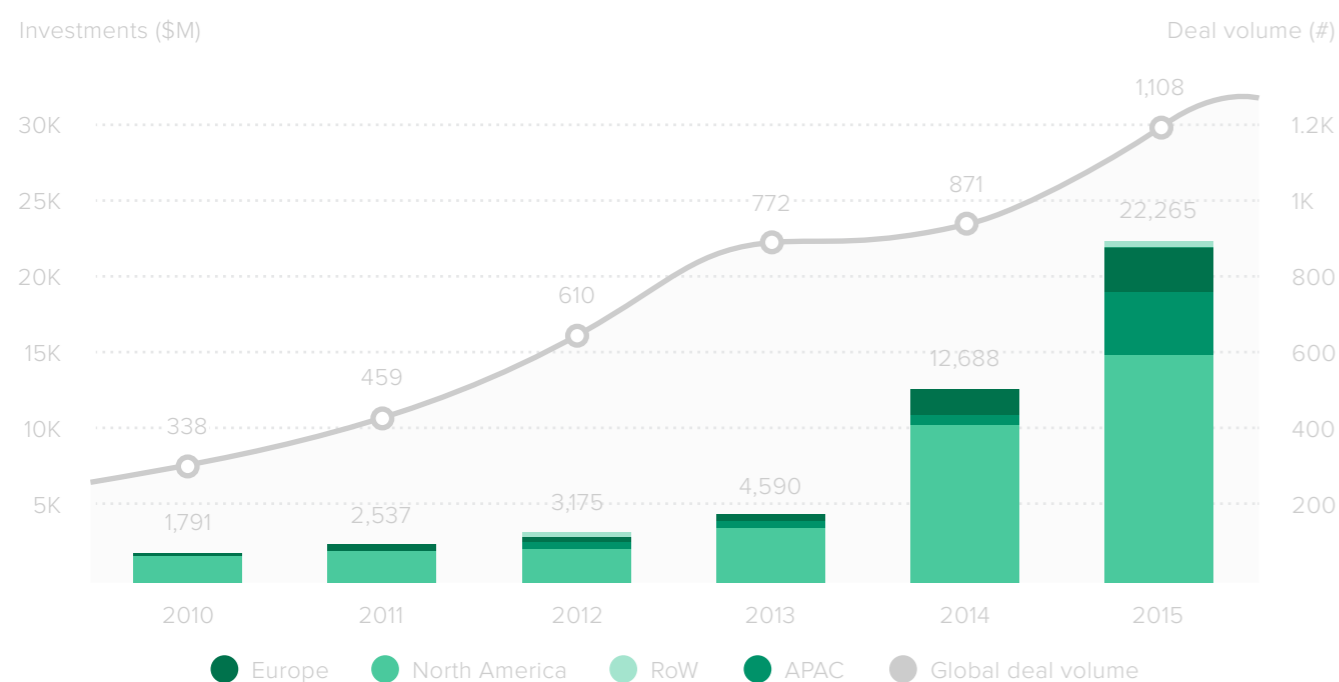
THE FINTECH PHENOMENON AND BANKING DISRUPTION HAVE FORCED BANKS TO DEVELOP SUPERIOR FINANCIAL SERVICES

Banks have learned a great deal in recent years regarding how to adapt to the changes sweeping through the financial sector.

They have learned of the need to become customer-centric in the digital/mobile sphere. This learning process will benefit SMEs in so many ways. Aside from what we have already discussed so far, banks will also be well placed to improve SME Know-Your-Customer procedure through AI methods.

Financial technology, or fintech, has jolted the sector into a period of sweeping change. Fintech has grown exponentially since 2008, with global investment ballooning from under \$1 billion in 2008 to over a whopping \$22 billion in 2015.

EXHIBIT 1: GLOBAL FINTECH FINANCING ACTIVITY (2010 - 2015)



Source: Accenture analysis on CB Insights data



16% of fintech investment has gone into SME lending alone. In the UK, fintech companies issued \$2.5 billion in SME lending in 2014. In the US, it was \$5 billion. These figures can be expected to grow substantially. Kabbage, the fintech lender to companies, issued \$400 million.

Other verticals with considerable fintech investment include business-to-business foreign exchange. Kantox, a fintech business foreign exchange services provider, has over 2,000 business clients, and has traded over \$3 billion through their platform.

The banking sector has been mobilized, albeit reluctantly, into pursuing new technological solutions in finance, because of the transformative impact that

fintech has created and now major banks across the world are investing in their own innovation centers or directly in fintech companies and programs.

“24% of SMEs are willing to pay for value-added business finance products”

The world is entering a new technology age, driven by automation, the Internet of Things and AI. Virtually every sector in the economy has been disrupted by new technologies in one way or another, and banking is no different. Technology solutions that harness the power of AI present a game-changer for banks. AI – machine learning,

customer analytics and predictive behavior analysis – helps banks to segment the SME market efficiently and predict future needs. It also facilitates a refined client targeting process for banks.

With technology set to pervade into all aspects of our lives, receiving services of any kind in a sophisticated digital format is now widely expected, especially from millennials and the cohort to come next, Generation Z.

It is technological innovation in finance that has created this new SME banking ecosystem, awash with new business and financial service tools that banks are best placed to provide for the SME segment, thanks to their extensive SME client bases and experience

THERE IS MORE **COMPETITION** IN THE **FINANCIAL SECTOR** THAN EVER BEFORE

Banks risk losing their SME customers to rival banks or fintech companies who provide high value, tailored business services at cost-efficient price points.

In the past, banks tended to prioritize the mass market, with a focus on corporate banking and a lack thereof concerning specific services for the SME segment.

This has allowed for the growth of fintech companies oriented on the SME segment. They have therefore developed a strong understanding of SMEs, with a high (and growing) adoption rate of their services and products.

Profit margins in certain verticals will come under pressure, which highlights the need to diversify into

new segments and to approach clients in a new way, based on truly learning to understand their customer and what they want. Along with the upcoming industry-wide implementation of PSD2 and bank account aggregation in Europe, banks need to grasp a sense of urgency.

Whereas fintechs are nimble, agile and able to react quickly, banks generally are not. They are big and hierarchically layered, making innovation difficult and significant company-wide shifts slow to enforce.

This is the reason why many banks are partnering with fintech to offer personalized services to SMEs. BBVA for instance, includes two fintech companies – Kabbage (SME financing provider) and Holvi (a fintech bank) – as part of its portfolio.

Additionally, banks including JP Morgan, Wells Fargo, Citi Bank, Credit Suisse, and Barclays have highlighted the increasing need to consult specialist financial technology companies ■

THE FINAL WORD

The opportunity for banks to leverage the needs of SMEs to succeed in the digital world will be key to tapping into this segment of the market.

Partnership with specialized companies will provide banks with the agility to create value for SMEs and move from the current relationship based on selling financial products to one based on service.

The revenue opportunity for banks is clear. The technology is available to offer high quality products to SMEs at accessible prices, and in many cases, value-added products are already on the market. The risk is simply too great for banks: act now or risk not only losing out on revenue opportunities, but in losing customers to other banks and third party providers who do provide these services ■

THE NEXT GENERATION OF SME BANKING - THE NUMBERS THAT MATTER

£8.5 billion

the amount in new SME banking revenue streams by 2020 in the UK alone

45

percentage of SMEs who say lower fees would increase satisfaction the most

23 million

number of SMEs in Europe

80

percentage of European banks that view the SME segment as a priority growth area

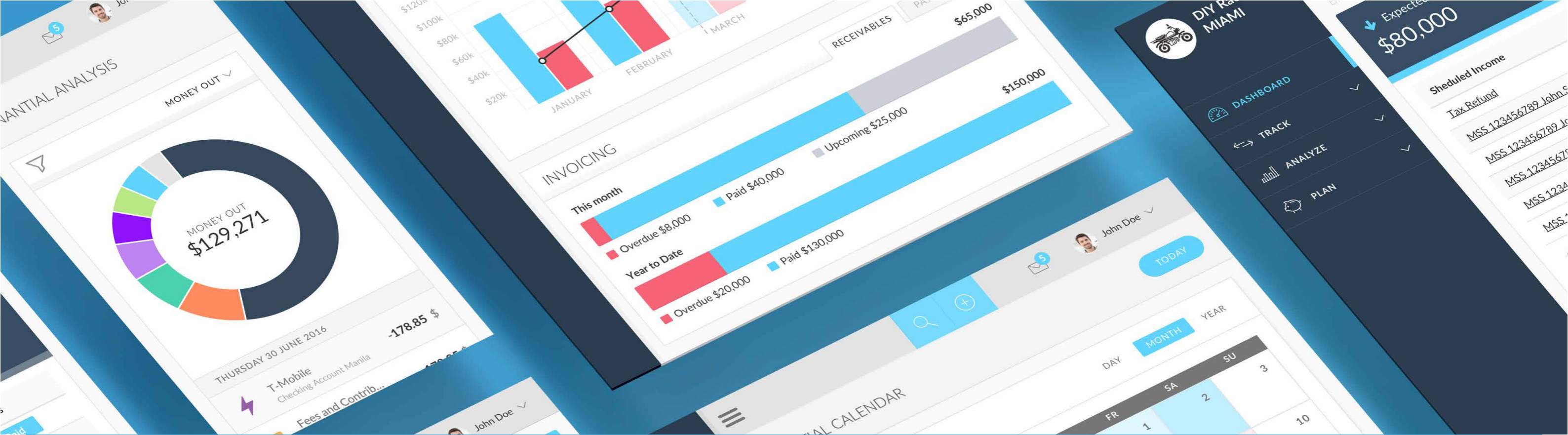
24

percentage of SMEs who would be happy to pay an additional monthly fee for value-added services

28 million

number of SMEs in the United States

Sources: *Accenture* and *Trade Up*



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.

STRANDS BFM: POWERING INNOVATION

BFM Product Sheet

DOWNLOAD



REFERENCES

- Americanexpress (2014):** *Why Millennials Could Be the Most Entrepreneurial Generation Ever.* Available online at <https://www.americanexpress.com/us/small-business/openforum/articles/why-millennials-could-be-the-most-entrepreneurial-generation-ever/>
- Accenture (2016):** *Global Fintech Investment Growth Continues in 2016 Driven by Europe and Asia, Accenture Study Finds.* Available online at <https://newsroom.accenture.com/news/global-fintech-investment-growth-continues-in-2016-driven-by-europe-and-asia-accenture-study-finds.htm>
- Accenture (2016):** *SME Banking 2020 - Changing the conversation (and capturing the rewards).* Available online at https://www.accenture.com/t20160505T043700_w_gb-en_acnmedia/PDF-16/Accenture-Unlocking-Revenue-SME-Banking.PDF
- BBVA Innovation Center (2015):** *Millennial Generation.* Available online at <https://www.bbva.com/en/data/8663102015/ebook-cibbva-innovation-trends-millennial-generation.pdf>
- Bnpparibas (2016):** *BNP Paribas Global Entrepreneurs Report.* Available online at <https://group.bnpparibas/en/news/bnp-paribas-global-entrepreneurs-report-2016>
- Bentley University (2014):** *Millennials at work.* Available online at <http://www.bentley.edu/newsroom/latest-headlines/mind-of-millennial>
- Entrepreneurial Finance Lab Research Initiative:** *The missing middle.* Available online at <https://www.hks.harvard.edu/centers/cid/programs/entrepreneurial-finance-lab-research-initiative/the-missing-middle>
- Forbes (2015):** *Millennials Want To Be Entrepreneurs, So Why Aren't They Starting Businesses? Part 1.* Available online at <http://www.forbes.com/forbes/welcome/?toURL=http://www.forbes.com/sites/jaredmeyer/2015/07/20/millennials-entrepreneurship-starting-businesses/&refURL=&referrer=>
- Forbes (2013):** *Banking the Unbanked: A how-to.* Available online at <http://www.bentley.edu/newsroom/latest-headlines/mind-of-millennial>
- Global Agenda Council on the Future of Financing & Capital (2015):** *The Future of FinTech - A paradigm Shift in Small Business Finance.* Available online at http://www3.weforum.org/docs/IP/2015/FS/GAC15_The_Future_of_FinTech_Paradigm_Shift_Small_Business_Finance_report_2015.pdf
- Global Banking and Finance.* Available online at <https://www.globalbankingandfinance.com/sme-digital-services-the-disconnect-between-customer-bank/>
- Indexmundi:** *New businesses registered (number) - Country ranking.* Available online at <http://www.indexmundi.com/facts/indicators/IC.BUS.NREG/rankings>
- Pewresearch (2015):** *Who are Europe's Millennials?* Available online at <http://www.pewresearch.org/fact-tank/2015/02/09/who-are-europes-millennials/>
- SmallBusiness (2013):** *Businesses cost less to start than the average weekly wage.* Available online at <http://smallbusiness.co.uk/businessescostless-to-start-than-the-average-weekly-wage-2357968/>
- SME Finance Forum.* Available online at <https://www.smefinanceforum.org/about/what-we-do>
- SME Insider (2014):** *What do SMES really want from their bank.* Available online at <http://www.smeinsider.com/2014/11/28/what-do-smes-really-want-from-their-bank/>
- Telegraph (2015):** *Britain hits record number of startups as more aspiring entrepreneurs take the plunge.* Available online at <http://www.telegraph.co.uk/finance/businessclub/11692123/Britain-hits-record-number-of-startups-as-more-aspiring-entrepreneurs-take-the-plunge.html>
- Tradeupfund (2015):** *State of SME Finance in the United States in 2015.* Available online at http://www.tradeupfund.com/uploads/2/16/0/4/26048023/state_of_sme_finance_in_the_united_states_2015.pdf
- Weforum (2016):** *Millennials are now officially America's biggest living generation.* Available online at <https://www.weforum.org/agenda/2016/05/millennials-are-now-officially-americas-biggest-living-generation>
- WorldBank (2015):** *Massive Drop in Number of unbanked, says News Report.* Available online at <http://www.worldbank.org/en/news/press-release/2015/04/15/massive-drop-in-number-of-unbanked-says-new-report>

eBook 

7 Factors

Powering the SME
Banking Paradigm Shift