Market Commentary

Delivering the banking services that small and medium businesses need to grow and succeed

Financial institutions have a huge opportunity to address the business banking market with solutions based on powerful technology ecosystems.

"Small to medium business are looking for banks to help them flex and grow. Corporate banking has always been important however, SMB banking is now a sweet spot for financial institutions to address."

Paula Allen
Principal Product Manager for Fusion Digital Banking, Finastra

While small to medium businesses (SMBs) represent the majority of turnover and profits in countries across the world, they have not always had access to the same level of banking services as larger corporations.

The pandemic and resulting disruption served as a wake-up call to SMBs that found themselves underprepared for greater reliance on digital processes, including those provided by their banks.

It also made SMBs consider how well-placed they were to meet unexpected shocks, and how well they understood their overall liquidity position.

Looking for a new relationship

The knock-on effect was that many SMBs decided to seek out alternative banking arrangements. A Cornerstone Advisors survey of small business owners and executives undertaken in Q1 2020 found that more than two thirds (69%) of SMBs worth $20 million to $49.99 million would consider looking for a new banking relationship in 2021.

It's often said that SMBs are not as attractive as targets for banks as they are more expensive to service. However, technology platforms are now available to provide a much wider range of capabilities that help SMBs to succeed by managing their income more effectively. These platforms open up opportunities for banks to grow their own customer bases while also supporting global economic growth.

About the author

Paula Allen
Principal Product Manager for Fusion Digital Banking, Finastra

Paula Allen looks after digital for both consumer and business banking at Finastra. With two decades of fintech innovation, operational excellence, and leadership experience, her work spans consumer and commercial banking and fintech sectors. In previous roles, Paula managed digital transformations, payments, open platforms, and artificial intelligence products. Paula is energized by empowering financial institutions to compete and lead in digital customer experience, and by enabling consumers and small businesses to achieve optimal financial growth.

Banks need to understand the changing requirements of SMBs and how they can support them

A great deal changed for SMBs during the pandemic. While some businesses failed or shut down, others furloughed their staff with government help and returned to fight another day.

A further proportion pivoted into new markets or adopted new business models, notably selling online rather than from a storefront.

These changes fueled growth for many SMBs that were able to expand from a regional market to national or even international operations. Growing SMBs that found themselves underserved by their bank will no doubt be some of those considering a change in 2021.

To understand why, it helps to look at where SMBs go to when they need additional funds, whether that's to pay additional staff or to simply survive an economic shock like the pandemic.

Financial pressures
The Federal Reserve Banks surveyed SMBs in 2020 to find out where they had experienced financial pressures in the previous 12 months.

They discovered that the most common pressure was needing to pay operating expenses, including wages, cited by 43% of respondents.

The next common challenges were securing credit (33%), servicing debt (30%), and purchasing inventory or supplies to fulfil orders (19%). Only a third (34%) of SMBs said they had not experienced any financial challenges.

Common financial pressures

43%	33%	30%	19%	8%	34%
Paying operations expenses (including wages)	Securing credit	Marketing payment on debt	Purchasing inventory supplies to fulfill contracts	Other financial challenge	Non financial challenges

"This is all about banks empowering SMBs to make better business decisions and manage revenue gains and losses. Automating cash flow is essential, whether that's accessing personal funds more easily or having better visibility of future payments."

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When asked what would happen if they faced a two-month revenue loss, the largest proportion (47%) said that they would tap into personal funds.

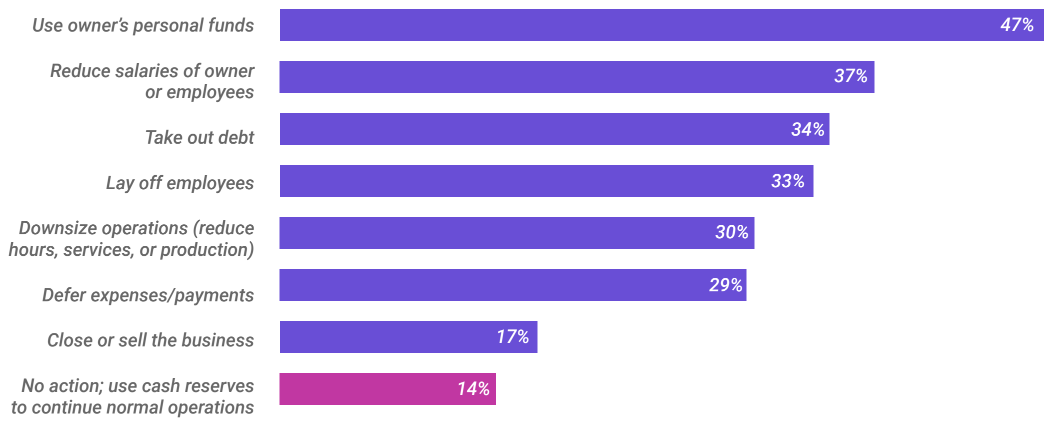
Just over a third (34%) would take on debt, 29% would defer expenses or payments. Demonstrating the need for easy access to personal accounts, credit, or loans.

Cash: still king

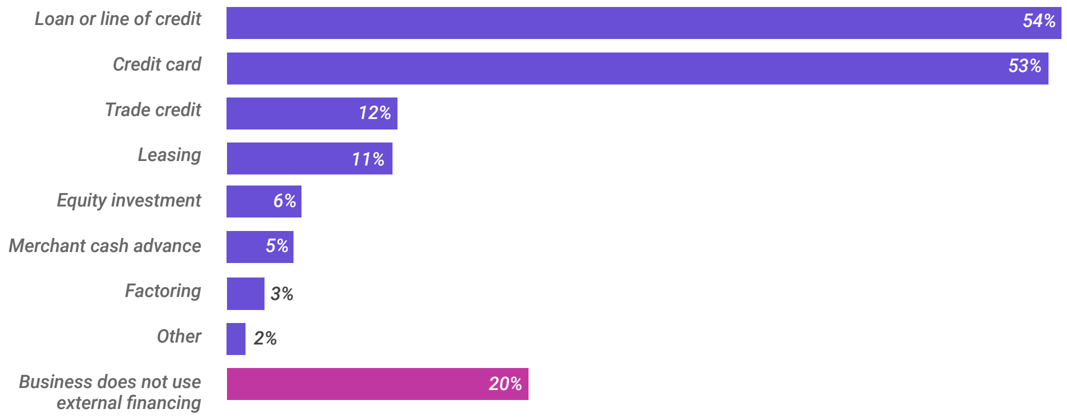
Popular sources of finance include lines of credit or loans, said 54% of SMBs, while 53% said they would turn to credit cards. Just 12% said they would use trade finance, and 11% said they would use leasing as a way to raise money.

All of this tells us that the old saying of 'cash is king' remains highly relevant for the SMB sector. Without a ready supply of payments, SMBs face existential failure. So how can banks help SMBs manage income more effectively?

Actions SMBs would take in response to a 2 month revenue loss



Popular sources of finance



The holy grail for SMBs is to operate at as near to zero funds as possible, especially in a low interest rate economy. They want to make cash work as hard as possible so that orders are fulfilled and wages are paid, but money isn't piling up in accounts that don't provide any financial returns.

As the Federal Reserve Banks research found, this includes accessing personal funds in a loan capacity quickly and easily. Instead of having completely separate personal and business accounts, often with different banks, SMBs would benefit from having multi-entity management under one login, so they can automatically see an overview of all available funds together.

SMBs would also benefit from tools such as sweep accounts, where funds above a certain level are swept into a higher rate savings or investment accounts. Alternatively, they could use a similar tool to sweep funds into their business account when a balance dips below a set limit.

Learning from consumer banking

This kind of bank account adopts some of the tools and technologies already built into personal bank accounts, and that are increasingly expected by SMB owner/operators.

Above all, SMBs want simplicity, transparency and high levels of integration and automation from their accounts.

This includes integration with accounting software, whether that's provided by the bank itself or by a third party.

Such integration would make it much easier for SMBs to match incoming payments with invoices, for example, or to manage payment initiation, approval, processing and management with file import/upload facilities.

By really understanding how SMBs operate and where they experience pain points, banks can anticipate and provide the functionality they are looking for – perhaps even before SMBs know they want it themselves.

Alongside having a ready and predictable cashflow, SMBs value having time to focus on building their businesses. Anything that can automate manual processes such as setting up loans from personal accounts, matching incoming payments to invoice numbers, onboarding new customers and investigating mismatched payments will be particularly welcomed.

Extending from the basics

Building on these basic processes, banks could help further by providing a personalized service and data analytics to support business growth. Services could include cash forecasting and analytics, providing smart predictions for when a customer is likely to pay their invoice.

It would also be valuable to enable SMBs to carry out reporting on their banking data, so they have a much better understanding of who their best and least performing customers are in terms of debtor days, volume of income and range of products/services purchased.

On top of that, banks could provide value-added services to SMBs such as legal and tax compliance, wealth management, vendor management, and sales and marketing.

The benefits for SMBs from this kind of holistic approach to managing finances are clear: it delivers time savings, improves cash management and provides insights into how the business is performing.

New business opportunities

Yet there ware significant benefits for banks, too. Many SMBs are put off by business accounts because of complexity, high costs or lack of flexibility. A significant proportion opt to use personal accounts to run their businesses, reducing the opportunity for banks to service this fast-changing segment.

By providing data analytic tools, a bank can provide SMBs with an overall view of their finances that they can access without having to update multiple accounting applications, as well as visibility into outstanding receivables. SMBs can see when payments are scheduled to come in, and always know exactly which invoices have been paid.

This capability positions a bank to provide outstanding levels of service, but also to suggest a new product or line of credit when they see discrepancies in the business's cash flow. So what is the best way to deliver the accounts that SMBs want to use, and that create new income opportunities for banks?

> ***"SMBs are increasingly expecting to find the services they need made available without having to look for them. The future of SMB banking is modularized and personalized to specific business needs such as insurance, business analytics, and marketing. The only way to achieve this is to adopt a digital ecosystem approach."***
>
> **Paula Allen**
> Principal Product Manager for Fusion Digital Banking, Finastra

In theory it would be possible to buy in or build a platform from scratch to deliver the rapidly evolving services that businesses need. But in practice, as many financial institutions are already discovering, a third option of platform adoption is the way forward.

Finastra's FusionFabric.cloud platform is a case in point. Community and regional banks have adopted the platform because it is core agnostic and provides open application programming interfaces (APIs) to a digital ecosystem that includes the capabilities that an SMB may want to use.

This approach means that a bank serving SMBs can plug the Fusion Digital platform into its core without disturbing legacy systems, then choose the applications it wants to make available to customers. It can do this on an incremental basis as needs emerge, rather than in one big bang approach.

Selecting useful apps for SMBs

One example of apps include upSWOT, which provides access to real-time SMB performance data, trends, and insights. Banks can use the app to look for events such as the number of unpaid invoices rising to a certain level, when they could recommend a factoring service.

Or they could pick up on a new business address and suggest additional insurance, or a loan to cover additional stock when levels have fallen below a set point.

Another example is Codat, which among other functionality, enables banks to provide a service that means SMBs can automatically reconcile data into their accounting software. Automatic synchronization of financial data reduces the likelihood of human error and gives SMBs peace of mind.

An advantage of these kinds of apps is that they are designed as white labeled software that is easy to brand with the bank's own look and feel. SMBs don't need to log in and out of different systems to perform particular functions, but simply access a simple interface that enables them to complete all the actions they need to from one place.

If banks decide to provide products and services with a more 'digital first' approach in the future, they can switch on new apps easily and quickly without having to spend months or years developing them. For example, they could adopt an app that provides everything an SMB needs to take out a business mortgage for new property, including access to realtor services.

Overall, banks can make themselves more valuable by putting themselves at the center of SMBs' financial worlds, creating new opportunities for themselves as a result.

Banking-as-a-service

The logical conclusion in the next few years is the adoption of banking-as-a-service, where financial institutions access cloud-based platforms that allow them to mix and match proven apps that can access core data safely and securely.

This enables banks to modularize and personalize services and products for SMBs, along with branded customer interfaces and experiences.

The keys to success will be achieving a true understanding of an SMB's wants and needs, then providing the products and services required in a timely and personalized manner. This will help reduce the proportion of SMBs considering a move away from their traditional bank, as well as those tempted to use personal accounts and/or third party fintechs instead of regular business accounts.

Above all, it ensures that banks serving SMBs remain relevant and are in the best position possible to address competition from market disruptor's and big tech brands eyeing up the hugely valuable SMB market.

For More information
visit finastra.com

Telephone
+1 800 989 9009

About Finastra
Finastra is building an open platform that accelerates collaboration and innovation in financial services, creating better experiences for people, businesses and communities. Supported by the broadest and deepest portfolio of financial services software, Finastra delivers this vitally important technology to financial institutions of all sizes across the globe, including 90 of the world's top 100 banks. Our open architecture approach brings together a number of partners and innovators. Together we are leading the way in which applications are written, deployed and consumed in financial services to evolve with the changing needs of customers. Learn more at **finastra.com**

North American Headquarters
744 Primera Boulevard
Suite 2000
Lake Mary, FL 32746
United States
T: +1 800 989 9009

ID-11414 / 1021

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